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FARM CREDIT PROBLEMS AND THEIR IMPACT ON AGRICULTURAL BANKS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SMALL BUSINESS:
FAMILY FARM

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

FARM CREDIT PROBLEMS AND THEIR IMPACT ON AGRICULTURAL BANKS

FEBRUARY 7 AND 27, 1985

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FARM CREDIT PROBLEMS AND THEIR IMPACT ON AGRICULTURAL BANKS

THURSDAY, FEBRUARY 7, 1985

U.S. SENATE,
SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room SR 428A, Russell Senate Office Building, Hon. Larry Pressler (chairman of the subcommittee) presiding.

Present: Senators Pressler, Nickles, and Nunn.

Staff present: R. Michael Haynes, chief counsel, and Dorothy C. Olson, hearing clerk.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA AND CHAIRMAN OF THE SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM

Senator PRESSLER. I want to thank everyone for being here and apologize for being a few minutes late. I just came from another meeting on the farm situation.

I want to thank all of our witnesses who are here and we look forward to their comments and suggestions. I thank my colleague, Senator Nickles, for being here, and we will hear from him; but first let me explain.

Today's hearings will explore the farm credit problems across the Farm Belt and the impact they have on agricultural lenders. With the declining land and machinery values, low farm prices, and high interest rates, a growing number of farmers are experiencing great financial difficulties.

A recent survey of agricultural lenders in my State found that 24 percent of the farmers and ranchers are classified as being in a weak financial condition. I will be placing a summary of that study in the record.

[The summary follows:]

SUMMARY OF EMERGENCY FARM CREDIT LEGISLATIVE PROPOSAL (TENTATIVE: PENDING REVIEW OF LEGISLATION)

SECTION ONE: ADVANCE COMMODITY CREDIT CORPORATION LOANS

(1) Advance price support loans will be made available to producers of 1985 crops. These loans will be made available to producers who participate in the 1985 farm program, with a maximum of 50 percent of the producer's 1985 crop eligible for advance CCC price support loans.

Eligible crops shall include those crops for which price support loans are available as specified in the 1949 Food and Agriculture Act.

These loans shall be recourse loans as long as the crop remains unharvested. Upon harvest, and certification that the crop is available as collateral for the loan, the status shall change to non-recourse.

The interest rate on the advance support loans would be set at normal CCC interest rate levels.

The advance loan program would be administered by the ASCS and ASC county committees.

SECTION TWO: DEBT RESTRUCTURING

The current Administration Loan Guarantee Program would be revised as follows:

A 90-percent will be provided on loans provided through the Farm Credit System and commercial lenders.

The FmHA's cash flow requirement would be reduced from 110 percent to 100 percent. (This would apply to the FmHA Debt Setaside Program, as well as new loans.)

Lender would be required to write down interest rates on the loan to a level of not more than 2½ points above the Federal Reserve's discount rate. No principal write down, or negative re-amortization would be permitted.

Program would be available for debt restructuring as well as current operating expenses.

SECTION THREE: ADMINISTRATIVE PROVISIONS

USDA will be instructed to use all possible avenues available to the Department to facilitate the administration of this program.

Loan guarantee authority will be increased to $3 billion.

Legislation requires the USDA to have both the advance price support program, and the debt restructuring program available within 15 days of enactment of the legislation.

Within 30 days of application, FmHA must approve or reject the lending institutions' application for participation in the "approved lender" program, in order for the institution to provide immediate credit assistance.

NOTE.—This legislation could be introduced as early as Wednesday afternnoon, February 6, 1985. If you need further information or want to cosponsor, contact Michael Durishin or Greg Billings in Congressman Daschle's office at X5-2801.

Senator PRESSLER. Due to the seriousness of the farm problem and the great repercussion that farm failures will have on the rural economy, it is critical that farmers and ranchers join with agricultural lenders, small businesses, farm cooperatives and others interested in the future of rural America to work for actions to improve the farm economy. Agriculture is our Nation's largest industry, and obviously if it does not enjoy the economic recovery, a sustained recovery is impossible.

Farmers represent less than 3 percent of the total population, but there are spinoff effects of the agricultural crisis. One is on the agricultural banks and lenders, and we want to look at that today. And in 2 weeks we are going to look at the impact on businesses on main streets that are affected by the agricultural crisis.

The problems on the farm appear to be seriously affecting agricultural lenders. During the past 18 months seven production credit associations have been liquidated and additional capital has been invested in several other PCA's.

Banks with a heavy involvement in agricultural lending also tend to have a high proportion of delinquent loans and most of the banks that have failed in recent months have had higher than average farm loan portfolios.

During the 1970's farm debt increased rapidly. The total farm debt went from $53 billion in 1970 to $166 billion in 1980 to $216 billion in 1983. Besides an increase in farm debt, the farm debt to

income ratio went from 3 to 1 in 1970 to an excess of 10 to 1 currently.

To return to the debt to income ratio of the mid-1970's farm income would need to more than triple. This illustrates not only that we have a severe farm credit problem, but also that we need a long-term farm policy that will allow farmers to make a profit so they can repay some of these loans.

Hundreds of farmers have contacted me regarding their problems in obtaining credit. The Farmers Home Administration has been able to assist some farmers and ranchers. But many who have obtained their financing from banks or PCA's are finding that they are unable to obtain credit for the uncoming spring planting season. And, indeed, many farmers are just going into their banks for loans for spring planting and are finding that the situation is much more grave than they had anticipated.

The sale of these farms and machinery will only compound the current problems. To assist these farmers the administration has proposed some changes in banking policies and additional assistance through the Farmers Home Administration.

Hopefully we will get a more clear idea today of these actions and how they will help stabilize the farm economy, whether the changes will help farm lenders meet farm credit needs and whether they will help some agricultural banks survive.

Let me also add that I think we need to coalition build here with the agricultural crisis. The Independent Bankers of America have already taken a stand and made a proposal. Hopefully other banking groups will, plus groups such as the National Federation of Independent Businessmen and others who will be affected by the agricultural crisis.

So let me submit my statement as well as that of Senator Baucus for the record and call on my colleague, Senator Nickles of Oklahoma.

[The prepared statements of Senators Pressler and Baucus follow:]

OPENING STATEMENT OF U.S. SENATOR LARRY PRESSLER

before the

SENATE SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM

on

FARM CREDIT PROBLEMS AND THEIR IMPACT ON AGRICULTURAL BANKS

February 7, 1985

I WOULD FIRST LIKE TO THANK ALL OF THE WITNESSES FOR TAKING THE TIME TO TESTIFY TODAY. WE LOOK FORWARD TO HEARING THEIR COMMENTS AND SUGGESTIONS.

TODAY'S HEARING WILL EXPLORE THE FARM CREDIT PROBLEMS ACROSS THE FARM BELT AND THE IMPACT THEY HAVE ON AGRICULTURAL LENDERS. WITH THE DECLINING LAND AND MACHINERY VALUES, LOW FARM PRICES, AND HIGH INTEREST RATES, A GROWING NUMBER OF FARMERS ARE EXPERIENCING FINANCIAL DIFFICULTIES. A RECENT SURVEY OF AGRICULTURAL LENDERS IN SOUTH DAKOTA FOUND THAT 24 PERCENT OF THE FARMERS AND RANCHERS ARE CLASSIFIED AS BEING IN A WEAK FINANCIAL POSITION. I WILL BE PLACING A SUMMARY OF THIS SURVEY IN THE HEARING RECORD.

RECENTLY, NEIL HARL, AN IOWA STATE UNIVERSITY ECONOMIST, ESTIMATED THAT AT LEAST 40 PERCENT OF THE FARMERS IN THE NORTH CENTRAL REGION OF THE UNITED STATES HAVE A BURDENSOME DEBT AND ARE HEADED TOWARD INSOLVENCY IN THE NEXT SEVERAL YEARS. IF THESE ESTIMATES ARE CORRECT AND THE NUMBER OF FARMERS SELLING OUT OR BEING FORCED TO SELL CONTINUES TO INCREASE, THE IMPACT ON RURAL AMERICA WILL BE DEVASTATING.

Due to the seriousness of the farm problem and the great repercussions that farm failures will have on the rural economy, it is critical that farmers and ranchers join with agricultural lenders, small businesses, farm cooperatives, and others interested in the future of rural America to work for actions to improve the farm economy. Agriculture is our nation's largest industry. If agriculture does not enjoy in the economic recovery, a sustained recovery is impossible. Should the farm economy continue to deteriorate, many other sectors of the economy will soon begin to feel the effects. Farmers represent less than three percent of the total population. Because of our small numbers, it is critical that farmers speak with a unified voice and work with other groups to form coalitions. I hope that today's hearing will illustrate how closely the banking industry and agriculture are tied. The two groups need to work together in trying to find solutions for our current farm crisis.

Problems on the farm appear to be seriously affecting agricultural lenders. During the past 18 months, seven Production Credit Associations have been liquidated and additional capital has been invested in several other PCA's. Banks with a heavy involvement in agricultural lending also tend to have a higher proportion of delinquent loans, and most of the banks that have failed in recent months have had higher-than-average farm loan portfolios.

DURING THE 1970s, FARM DEBT INCREASED RAPIDLY. TOTAL FARM DEBT WENT FROM $53 BILLION IN 1970 TO $166 BILLION IN 1980 AND TO $216 BILLION IN 1983. BESIDES AN INCREASE IN FARM DEBT, THE FARM DEBT-TO-INCOME RATIO WENT FROM 3 TO 1 IN 1970, TO IN EXCESS OF 10 TO 1 CURRENTLY. TO RETURN TO THE DEBT-TO-INCOME RATIO OF THE MID-1970s, FARM INCOME WOULD NEED TO MORE THAN TRIPLE. THIS ILLUSTRATES NOT ONLY THAT WE HAVE A SEVERE FARM CREDIT PROBLEM, BUT ALSO THAT WE NEED A LONG-TERM FARM POLICY THAT WILL ALLOW FARMERS TO MAKE A PROFIT SO THEY CAN REPAY SOME OF THESE LOANS.

HUNDREDS OF FARMERS HAVE CONTACTED ME REGARDING THEIR PROBLEMS IN OBTAINING CREDIT. THE FARMERS HOME ADMINISTRATION HAS BEEN ABLE TO ASSIST SOME FARMERS AND RANCHERS, BUT MANY WHO HAVE OBTAINED THEIR FINANCING FROM BANKS OR PCA'S ARE FINDING THAT THEY ARE UNABLE TO OBTAIN CREDIT FOR THE UPCOMING SPRING PLANTING SEASON. WITHOUT CREDIT, MANY OF THESE FARMERS WILL BE FORCED OUT OF BUSINESS.

THE SALE OF THESE FARMS AND THE MACHINERY WILL ONLY COMPOUND THE CURRENT PROBLEMS. TO ASSIST THESE FARMERS, THE ADMINISTRATION HAS PROPOSED SOME CHANGES IN BANKING POLICIES AND ADDITIONAL ASSISTANCE THROUGH THE FARMERS HOME ADMINISTRATION.

HOPEFULLY, WE WILL GET AN IDEA TODAY WHETHER THESE ACTIONS WILL HELP TO STABILIZE THE FARM ECONOMY, WHETHER THE CHANGES WILL HELP FARM LENDERS MEET FARM CREDIT NEEDS, AND WHETHER THEY WILL HELP SOME AGRICULTURAL BANKS SURVIVE. THESE ARE JUST A FEW OF THE QUESTIONS WE WILL BE ADDRESSING THIS AFTERNOON.

STATEMENT OF SENATOR MAX BAUCUS
ON THE FARM CREDIT CRISIS
FEBRUARY 7, 1985

MR. CHAIRMAN, I WANT TO THANK YOU FOR THE CHANCE TO TAKE A CLOSE LOOK AT THE CREDIT PROBLEMS FACING AMERICA'S FARMERS AND RANCHERS. THE PROBLEMS IN AGRICULTURE SHOULD CONCERN EVERY AMERICAN. I HOPE THAT THE IDEAS EXPRESSED HERE TODAY WILL GIVE US A CLEAR PLAN OF ACTION TO ADDRESS THE DEEPENING CRISIS IN RURAL AMERICA.

I KNOW THAT SENATOR PRESSLER REALIZES THAT OUR AGRICULTURAL PROBLEMS ARE NOT A RECENT PHENOMENA. HIGH INTEREST RATES AND LOW FARM PRICES OVER THE PAST SEVERAL YEARS ARE BEGINNING TO TAKE THEIR TOLL.

NOT LONG AGO IN MONTANA THREE PRODUCTION CREDIT ASSOCIATIONS (PCAS) ANNOUNCED THAT THEY WERE LIQUIDATING THEIR ASSETS. THIS NEWS IS ALARMING BECAUSE IT DEMONSTRATES HOW WIDESPREAD

THE ECONOMIC PROBLEMS OF HIGH INTEREST RATES AND LOW PRICES HAVE BECOME.

WE MAY NOT BE ABLE TO BRING THOSE PCAs BACK, BUT WE CERTAINLY SHOULD RECOGNIZE THAT ACTION MUST BE TAKEN TO PREVENT ANY FURTHER WEAKENING OF OUR FARM ECONOMY.

I BELIEVE THERE ARE TWO COURSES OF ACTION WE MUST TAKE.

FIRST, WE MUST FACE THE CREDIT PROBLEMS OF AGRICULTURE THAT ARE CAUGHT IN THE VICIOUS CYCLE OF HAVING TO BORROW MONEY TO COVER THEIR PRODUCTION EXPENSES THAT CANNOT BE MET WITH TODAY'S DEPRESSED FARM PRICES.

THE ONLY WAY THESE FARMERS AND RANCHERS COULD FIND OF FINANCING THEIR OPERATIONS WAS TO BORROW AGAINST THE INCREASING VALUE OF THEIR LAND. THIS CONCENTRATION ON DEBT FINANCING IS CONTINUING. THIS IS CLEAR FROM THE RECORD TOTAL FARM DEBT THAT NOW IS NEAR $216 BILLION.

WHILE THE LEVEL OF FARM DEBT CONTINUES TO INCREASE THE HISTORIC INCREASES IN LAND VALUES PEAKED SEVERAL YEAR AGO. SINCE 1980 FARM EQUITY IS DOWN AN AVERAGE OF FIVE PERCENT PER YEAR.

THIS TREND OF INCREASING DEBT AND DECLINING EQUITY FINDS A FULL THIRD OF THE NATION'S FARMERS WITH DEBT-TO-EQUITY RATIOS OF OVER FORTY (40) PERCENT. FARMERS WHO HAVE STRUGGLED UNDER INCREASING COSTS OF FEED, FERTILIZER AND FUEL IN THE PAST ARE NOW FACED WITH 10 TO 20 PERCENT OF THEIR PRODUCTION COSTS GOING TO SERVE THEIR DEBT -- TO MAKE INTEREST PAYMENTS.

WHILE THE COSTS OF DEBT FINANCING ARE BECOMING UNMANAGABLE FOR SOME FARMERS ESTIMATES ARE THAT 10 TO 15 PERCENT OF U.S. FARMERS WILL NOT BE ABLE TO FIND DEBT FINANCING AT ALL. OF THE 1300 BORROWERS WHO WERE MEMBERS OF MONTANA'S THREE LIQUIDATING PCAs IT IS ESTIMATED THAT NEARLY 40 PERCENT WILL HAVE TO TURN TO COMMERCIAL BANKS OR THE FARMERS HOME ADMINISTRATION FOR CREDIT.

FOR SURVIVAL OF THESE FARMERS IN THE SHORT RUN I BELIEVE THAT THE ADMINISTRATION AND CONGRESS MUST ACT TO PROVIDE LOW INTEREST CREDIT. FULL USE AND IMPROVEMENT OF THE FARMERS HOME ADMINISTRATION CREDIT PROGRAMS IS NOT ENOUGH. COMMERCIAL BORROWERS NEED THE ABILITY TO RESTRUCTURE THEIR CURRENT DEBTS AND MUST HAVE CREDIT AVAILABLE AT REASONABLE INTEREST RATES TO FINANCE THEIR OPERATIONS.

THE SECOND, AND EQUALLY IMPORTANT, ACTION CONGRESS MUST TAKE IS THE STRUCTURING OF A FOUR-YEAR FARM BILL THAT WILL STRENGTHEN THE AGRICULTURAL ECONOMY OVER THE LONG RUN.

THE GOAL OF THE FARM POLICIES IN THE FARM BILL SHOULD BE TO IMPROVE FARM PRICES. THIS MEANS AN AGGRESSIVE EXPORT PROMOTION PACKAGE TO HELP COUNTERACT THE CHILLING EFFECT THE STRONG DOLLAR HAS ON OUR AGRICULTURAL EXPORT VOLUME. AND IT MEANS A DOMESTIC FARM PROGRAM THAT WILL NOT PULL THE RUG OUT FROM UNDER FARM PRICES OR PROMOTE INCREASED PRODUCTION.

IN CONCLUSION, QUICK ACTION IS NEEDED TO PREVENT ANY FURTHER DETERIORATION IN THE AGRICULTURAL ECONOMY. SURVIVAL OF OUR FARMERS AND RANCHERS IS NOT ALL THAT IS AT STAKE. BANKERS, SMALL BUSINESSES AND ALL OF RURAL AMERICA TIE THEIR FATE TO THE AGRICULTURAL ECONOMY.

AGAIN, I WANT TO THANK SENATOR PRESSLER FOR HOLDING THIS HEARING. I THINK TODAY'S RECORD WILL CLEARLY SHOW THE NEED TO FACE THE DIFFICULT PROBLEMS IN AGRICULTURE. EVERYONE HERE NEEDS TO DO EVERYTHING POSSIBLE TO MAKE SURE THE TRUE STORY OF RURAL AMERICA IS HEARD. THANK YOU.

Senator NICKLES. Thank you, Senator Pressler.

I can just echo your comments. The difficulties that are faced in agriculture today are extremely unfortunate. The repercussions are being felt by the banks that they are dealing with and the communities in which they live.

I think any of us can aptly describe the dilemma that we are facing. Real interest rates are high and the commodity prices are low, certainly compared to the last 20 years.

So describing the difficulty that they are in is kind of easy. Coming up with the right solutions to get out of it is a lot more difficult. That is the reason why I am here today.

I apologize, but I also have an SBA meeting in my office at 2:30 that I need to be there. So I will limit my comments. I would like to hear as much as possible in a very short period of time about possible solutions from our panelists. I will be taking the statements from our panelists today and reviewing those.

We are having an Ag meeting, actually several in Oklahoma over the next week, and I will review the statements and some of the possible solutions that our panelists have recommended. Hopefully we will be able to come up with a coalition that will be able to assist farmers and also be prudent as far as taxpayers are concerned at the same time.

So thank you for having this hearing today.

Senator PRESSLER. Thank you very much.

We have two panels. Our first panel consists of Ms. Kathleen Lawrence, Deputy Under Secretary for Small Community and Rural Development; Mr. Donald E. Wilkinson, Farm Credit Administration; and Mr. Charles E. Thacker, Federal Deposit Insurance Corp.

We will subsequently hear on panel 2 from two bankers and representatives of the Farm Credit Counsel.

First we will hear from panel 1, and I yield to Ms. Lawrence.

STATEMENT OF KATHLEEN LAWRENCE, DEPUTY UNDER SECRETARY FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Ms. LAWRENCE. Thank you, Mr. Chairman.

It is a pleasure to be here and to have the opportunity to meet with you today and to talk a little bit about what the administration is proposing to help the farmers who are in such severe economic distress today get through hopefully this year and then with a long-term farm bill in the years ahead.

I do not have a prepared statement, but I would just like to summarize, if I may, the provisions of the initiatives announced by the President last September and Secretary Block so that we know where we are as we start talking today and determining what it is that the Federal Government can do in conjunction with the private sector and with the regulators to see if we can't help our farmers get through this crisis right now.

If you will recall, last September 18 President Reagan announced a four-point plan to help those farmers who were experiencing financial difficulty to restructure their loans in such a fashion as to get them into a positive cash flow position.

At that time he announced that 4 farmers who were Farmers Home Administration borrowers, they would be allowed to set aside on a shelf 25 percent or $200,000, whichever was less, of their current debt to Farmers Home, and that amount set aside on the shelf would be interest free in the hope that that would enable them to cash flow. And in addition to that, we would do some loan consolidation and rescheduling and reamortization, whatever would be necessary to help them to cash flow.

For farmers who were not Farmers Home borrowers, who borrowed from the farm credit system, commercial lenders, or insurance companies—well, not insurance companies, but other regulated lenders, Farmers Home would guarantee 90 percent of restructured loan if the lender would write down a minimum of 10 percent of the principal of whatever was necessary to allow the farmer to cash flow. And we would guarantee loans that ordinarily we would not guarantee, troubled loans.

The third thing the President said was that on the county level the Farmers Home Administration would contract out with ag specialists, ag lending specialists and farm management specialists to help advise the borrowers and help advise the county committee and the county supervisors on proper ways to help these farmers restructure so that they could cash flow and continue in business.

And the final provision of that September announcement called for contracting out of Farmers Home servicing to approved lenders, to bankers so that we could free up out own personnel from all the paperwork involved in servicing so they would be more free to counsel with farmers.

And with the exception, quite frankly, of the principal write-down, those four points have worked very well and are continuing to work. But, quite honestly, the principal write-down is not working as well as we thought.

And so yesterday Secretary Block announced eight additional points designed to further help these financially stressed farmers through their temporary difficulties, particularly those that are good managers.

He announced first that at the request of the President a farm credit coordinating group would be set up chaired by the Secretary of Agriculture and consisting of the Chairman of the FDIC, the Comptroller of the Currency, the Assistant Secretary of the Treasury for Domestic Finance, the Governor of the Farm Credit Administration, the Under Secretary of Agriculture for Small Community and Rural Development, and the Vice Chairman of the Federal Reserve Board would also serve as an observer on this group.

The first meeting of that group will hopefully be scheduled for next week. We are trying to find some hour or some day where all of those men are free at the same time. We are hoping that group will meet next week.

Then the Secretary ordered Farmers Home to change the regulations from September so that now we will accept interest write-down as well as principal write-down in order for lending institutions to obtain a Farmers Home loan on a troubled loan.

And in addition to that, the Secretary announced that in an instance where a bank or a PCA has failed and is being liquidated and the new institution, the bank that buys out the bank that

failed, does not pick up a farm borrower. And in all likelihood had the bank not failed, that borrower would have gotten his farm loan this year. Farmers Home will guarantee on a 1-year basis that farmer's crop loan for this year, the provision being that for this year he can cash flow.

The Department of the Treasury is going to be working with the FDIC, the Comptroller of the Currency, and the Federal Reserve Board to implement a policy where possible to avoid supervisory actions that would discourage banks from showing some kind of forbearance on working with farmers and small business borrowers.

And in particular each of these regulatory agencies will be asked to designate a special review examiner to examine the reports on farm sector banks before it is forwarded back to the bank to assure that there is compliance with this policy of a forbearance.

USDA is also creating special action teams of trained Farmers Home lending officers to be sent on short notice to set up temporary offices anywhere where an ag bank or a PCA is liquidated. So that they will be on the spot to help those farmers who cannot get loans because their bank is being liquidated. FDIC has agreed to give the Department of Agriculture early notification so that we are prepared when FDIC moves in to liquidate a bank to have our teams in place.

USDA will review the recruiting standards that we set last September for these farm management specialists and our ag lending specialists.

In some parts of the country our State directors are telling us they are having trouble recruiting because our standards were too high. We have agreed to look at those standards to see if we can't get these specialists in place a little faster by perhaps requiring a year or two less of experience. We are requiring 5 years of experience and in some places we are having a hard time recruiting people.

There are in many States, particularly in the States in the Grain Belt where all this crisis seems to be focused right now, several hot lines, most of them run by either churches or special interest groups to help farmers through these stressful times. The USDA has agreed to cooperate in helping set up these hot lines, and where none exists to work to set up our own.

And, finally, we are going to be working with State governments, with private lending institutions, and with the Farm Credit System lenders to see if they can lend us some personnel to help move this paperwork along because it is clear to us that with more than usual applications coming into Farmers Home this year our personnel are not capable of moving paper fast enough. We just don't have enough people. There is no way we can hire and train people in the next 60 days, which is when they are needed.

To overcome that problem and because there is a statute that requires that the actual loan decision be made by a Farmers Home staff person, in order to free those people up to make those decisions, the Secretary is ordering other USDA agencies to provide clerical help to the Farmers Home Administration, and we are going to be working with State governments and private lenders to see if we cannot borrow from them to help do the clerical work

that needs to be done, but is not necessary in the actual loan decisionmaking.

Well, those eight points, on top of the four that were announced last September, we believe will go a long way toward helping the farmers in the next 60 days. There are some regulation changes that need to be done. They are in the clearance process. We hope they are out of clearance and published next week. No new laws are required to accomplish this.

Senator NICKLES. Mr. Chairman, if you will excuse me. I do have an office appointment. I am very interested in hearing from our other panelists. I am going to make that meeting and, if possible, return because I would like to hear what our other panelists have to say today and, if not, I am going to take the statements and follow those.

I appreciate, Ms. Lawrence, that the Secretary reviewed and tried to see if the program which was announced last year might be modified and improved.

I commend you on your effort because there is a lot that still needs to be done with the program. So whether this is enough or not, I think many of the people I am hearing from are saying that it is not.

Again, I don't know that we have all the solutions, but I do look forward to working with you and other people that are interested in this. I hope the task force is able to be assembled in a very expedient manner and that they will come up with some recommendations that will help not just in the immediate short term.

A lot of us are concerned about the next couple of months, but I would say our primary concern is long term. We should not add fuel to the fire by just extending debt and extending debt and let people build in, but trying to solve the long-term problem in our dealing with the farm bill.

I look forward to working with Senator Pressler and yourselves as well.

Excuse me for the need to leave.

Senator PRESSLER. Senator Nunn, you have arrived. Would you like to say something?

Senator NUNN. Not at this time, Mr. Chairman. I will catch up. I am delighted you are having these hearings. I think this is a matter of crucial importance, to not just the farming people, but to the whole rural areas of my State and our country.

So I am delighted to be here and I will try to catch up. I have about six meetings going on all afternoon and I am going to be in and out, but I will be following it with a great deal of interest.

Senator PRESSLER. Mr. Wilkinson, Governor of the Farm Credit Administration.

STATEMENT OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION

Mr. WILKINSON. Thank you very much, Mr. Chairman, and Senator Nunn.

I am Donald E. Wilkinson, Governor of the Farm Credit Administration. We, too, are very pleased to participate in this panel and

to share information and concerns with your members of this important committee today.

I did an unusual thing last week and spent 3 very intensive days starting in Jackson, MS, and then into Atlanta, GA, and then Cedar Rapids, IA and talked to farm credit people from many different States for two specific purposes.

I was interested in determining how they viewed the farm credit situation and, second, I was concerned why did we not find the answer to Ms. Lawrence's question, why was there not more participation by the Farm Credit System people on the front line of action with the Farmers Home Administration's Debt Restructuring Program.

No. 1, I found, no surprise to you, that the agriculture credit situation is very critical. It is critical across the Nation, but it has some very severe hot spots, if we may use that term. I can address some of those, if you are interested in exploring it.

I think it is important for you to understand that I am not here today speaking for the Farm Credit System. I represent the regulator, the supervisor and the examiner of this privately owned cooperatively structured Farm Credit System which operates with no Government funding with credit being obtained by the sale of its securities. Your second panel will have spokesmen for the System who are out there providing credit.

As the overall reviewer and supervisor, let me share some rather significant information with you. The institutions of this system, and that includes the 37 large banks, and they are multibillion-dollar banks, with the 800 or so associations, which we refer to as the Production Credit Associations and the Federal Land Bank Associations, last year had losses of some $368 million. You will find this in my testimony; $368 million, the largest single year loss ever in the over 65-year history of the Farm Credit System or at least parts of its branches.

Now in saying this, I wish to emphasize to the public and to others concerned with the integrity of the securities that the Farm Credit System is sound. It has been building for the rainy day. It had $82.2 billion of loans outstanding in September. It has dropped a bit now seasonally.

They reported earnings, and this is what the investment community watches, of $363.1 million for 9 months. We estimate that the year's earnings will be some $437 million for this private farm credit system. Collectively these banks have a net worth of approximately $9.3 billion.

It has been building its retained earnings and its reserve for losses prudently for many years, and at this moment I would say that these reserves are sufficient to meet the present challenge, but I underline, members of the committee, the present challenge.

I will not take time to talk about some of the troubled areas. I would though answer this question which is asked of me quite frequently because you, Mr. Pressler, in your opening comments made reference to the liquidation of production credit associations.

You are exactly correct. There have been a number of associations liquidated this past 18-month period. The law provides that a production credit association must operate within a 10-to-1 debt to asset ratio. Production Credit Associations borrow from the Federal

Intermediate Bank, and when that ratio is no longer obtainable, or when it is exceeded, when nonperforming loans drain its reserves, or when the capital stock which the borrowers have invested in their cooperative system nears impairment, there is no alternative but to either liquidate that association or, if there is a neighboring association of the Farm Credit System strong enough to which it may be merged, then this is what happens.

The issue that Ms. Lawrence mentioned regarding transfer capability will be helpful as that process takes place for those borrowers who are not deemed to be credit worthy by the new association.

One specific recommendation as far as the critical time frame would be this. We do not have time for commissions, committees, and studies, for what happens in the next 60 days will determine how well American agriculture will do for much of 1985. This is the most critical time in the production agricultural sector.

This was the basic point of concern as I met with these people last week, and they had many things to say to me regarding the President's Debt Adjustment Program.

I commend Secretary Block and his staff for making the changes which they announced yesterday. However, Secretary Block knows, because I as well as my Federal Board met with him and Ms. Lawrence on Tuesday morning, that we have additional concerns, and will only have to wait and see whether these may be taken care of.

We welcome very sincerely the write-down interest capability. We have a very basic problem that I think all of us must recognize. It is true with other commercial lenders, but it is especially true with the cooperative credit institutions. They need to have an incentive. There frankly is no incentive for a production credit association to go through all of the process of writing down either interest or principal and trying to achieve a 110-percent cash-flow.

For this reason the people that make these decisions are the farmer boards themselves. They own these associations. Presumably as members of those boards they are the sound borrowers. They know that every write-down will increase their interest costs. Every write-down is going to further jeopardize the financial stability of their association.

Time after time I was told last week, Governor, our associations are already weakened to the point that we no longer can write down or continue to try and work on cash flows of that group of farmers. We are struggling to survive as an institution so that we may serve the sound borrowers who are literally our owners.

We have some specific recommendations, which I am going to provide by letter to Secretary Block as a result of thoses discussions, and I think other witnesses this afternoon from the Farm Credit Council will address those.

So our No. 1 recommendation then is to recognize that the debt restructuring program further annnounced yesterday should not, should not be deemed or viewed as a bailout program for those farmers who by some mismanagement or over a number of years find themselves in an untenable position now.

But I think I heard Ms. Lawrence say this. It is for the purpose of protecting and serving the remaining farmers, the remaining farmers and their financial institutions and their rural communi-

ties. And we would stress that when a farmer faces difficulties, so, too, does his community.

We are very concerned that this pendulum of agricultural stress may swing too far and unnecessarily undo through declining land values continued high interest rates the agricultural situation.

Senator NUNN. Mr. Chairman, may I ask one question on that point. I hate to interrupt, but if Mr. Wilkinson doesn't mind. I have got to leave in just a moment.

Senator PRESSLER. Yes, please.

Senator NUNN. That seems to me to be the key to both the short term and the long term as far as I am concerned. The question is; What can the Government do, if anything, or what can be done by private lenders or otherwise, to try to stabilize land prices?

It seems to me that if we keep in this spiral of downward pressure on land prices caused by foreclosures and lack of credit, even though your program is going to be of some help, there are still going to be an awful lot of people that don't get credit. And when they don't get credit, they are going to be under pressure to sell their property or have it foreclosed.

Is there anything you can think of that can be done to try to stabilize land prices? Many who are not in trouble now are going to be in trouble within a year if land values keep dropping.

Mr. WILKINSON. To answer your question specifically, we believe that there has to be an intermediate concept of a quasi-Government corporation which will acquire nonperforming loans, and it may be, Senator Nunn, in the form of acquiring actual land as the assets of that loan by the Government with perhaps Government funding initially. A type of corporation with a sunset provision and with a self-financing concept by those lenders and other participants to in essence hold those nonperforming loans, and that land off the market of that community for a period of time so that it may be phased back in gradually as we hopefully will see an upswing in the economy.

It cannot sit there being held by borrowers. It is a deterrent to other interested individuals, farmers, or speculators, waiting to know when they can get back in the market. There has to be a financial and a psychological signal that will give that community interest that necessary push, Senator.

Senator NUNN. How long do you think we have to do something like that before we just get to the point where people who now have reasonable equity are simply not going to have any because of the land values?

Mr. WILKINSON. We do not have all that time. If we do not see, and the agriculture community does not see a signal that there is going to be something long term within the next months or the long intermediate term that you are speaking of, then I think the depressive attitude out in the community and the depressive status of the large accumulating reserve for losses or nonperforming assets, I should say, of the lenders, will just continue this snowball effect.

There needs to be a signal sent that the Congress, the Department of Agriculture and the commercial lenders as well begin to see some reason for a turnaround. It is not there yet.

Senator NUNN. Mr. Chairman, if I could ask one other question and then I will defer.

Senator PRESSLER. Go ahead.

Senator NUNN. Ms. Lawrence, maybe you covered this, but if you did, you could repeat it, if you don't mind, or if you didn't, I would like to get your thinking on it.

The Small Business Administration made a number of farm loans, rightly or wrongly, back in late 1970's, disaster loans, and a lot of these disaster loans became tantamount to operating loans. In effect the SBA went into a great deal of credit lending in the farm area. Now they have phased out of it, but still have a large portfolio in my State, and there are a number of those small business loans that are in jeopardy or in trouble and in the same condition as are the Farm Home Administration loans.

Is there anything in your program that covers the Small Business Administration or are they completely left out of this?

Ms. LAWRENCE. No, sir. In our program it only covers Farmers Home borrowers and Farmers Home guarantees, not SBA.

Senator NUNN. Is anybody in the administration saying that, hey, we have got the same problem over in SBA, the same kind of people, and the same kind of financial situation?

Ms. LAWRENCE. If they are, they are not talking to me, sir.

Senator NUNN. Can you initiate something like that, to coordinate with SBA or suggest that OMB do it, or what do you think ought to be done about it? You would agree that there are a lot of similar problems, wouldn't you?

Ms. LAWRENCE. Yes. There are a lot of similar problems, and I do know that there has been a lot of pressure on the part of some of the banks and some of the small businesses within SBA, but SBA has not discussed it with us.

Senator NUNN. Thank you.

Thank you, Mr. Chairman.

Senator PRESSLER. I will call on Mr. Thacker for comments he might have, and then we have some questions for everyone.

STATEMENT OF CHARLES E. THACKER, ASSOCIATE DIRECTOR, DIVISION OF BANK SUPERVISION, FEDERAL DEPOSIT INSURANCE CORP.

Mr. THACKER. Mr. Chairman and members of the subcommittee, we, at the FDIC, appreciate the opportunity to be here today to present our views on this critically important matter.

You have asked for our comments on the number of banks affected by farm credit problems and the degree to which the banks are affected. You have also asked what FDIC is doing to help relieve these financial difficulties.

We have provided you with a written statement which we would like to have entered in the written record of the proceedings.

Senator PRESSLER. It shall be entered. I realize I cut off Mr. Wilkinson and we will get back to him. But go ahead.

Senator NUNN. I did it, Mr. Chairman. I apologize. [Laughter.]

Senator PRESSLER. No; that's all right.

Mr. THACKER. The FDIC is a federally chartered insurance company responsible for insuring depositors against loss of their bank

deposits up to $100,000 in the event of a bank failure. The FDIC is funded by premiums charged to insured institutions and by the interest income on our investments and U.S. Treasury obligations.

To control the risk to the insurance fund the FDIC regulates and supervises the activities of insured institutions and, in the event one should fail, liquidates the assets acquired as a result of the failure for the benefit of the uninsured depositors, other creditors and stockholders.

In addressing your first question, let me point out that commercial banks provide less than 30 percent of total farm loans with the farm credit system being the largest lender in the agricultural sector.

At FDIC we have defined an agricultural bank as one in which agricultural loans comprise 25 percent or more of total loans, and agricultural loans are those secured by farmland, loans to finance agricultural production or any other loans to farmers.

So defined, about 30 percent of the commercial banks in the United States, or about 4,150 banks, are classified as agricultural banks. These banks are spread throughout 39 States. However, Iowa, Illinois, Kansas, Minnesota, Nebraska, and Missouri account for 60 percent of the agricultural banks in the country.

Sixteen Midwest and Plains States have over 70 percent, or 2,935 of the country's agricultural banks. Over half of the agricultural banks in these 16 States have a ratio of agricultural loans to total loans in excess of 30 percent. While this ratio exceeds 50 percent in one quarter of the banks, at least 70 percent of the banks in the States of South Dakota and Nebraska have more than one-half of their total loan portfolio tied up in agricultural credits and other States such as Iowa and North Dakota are not far behind.

In terms of performance characteristics, agricultural banks have historically performed better than their nonagricultural counterparts, but we are now seeing some changes in these performance histories.

In the prepared statement which we provided you will find some performance ratios of banks in the 16 Midwest and Plains States which comprise over 70 percent of the agricultural banks in the country.

You will note that in these 16 States the capital ratios of agricultural banks exceed those of their nonagricultural counterparts by about 13 percent and, in fact, capital ratios in agricultural banks have grown 9 percent while the ratio in nonfarm banks has grown only 2 percent since 1979. Return on assets in the agricultural banks, while declining since 1980, continues to exceed nonfarm banks by about 18 percent.

On the negative side, past due, nonaccrual and renegotiated loans in agricultural banks exceed those in nonfarm banks in the same States. Assets adversely classified at bank examinations at all banks in the 16-State Plains and Midwest area actually declined from 58 percent of the total capital and reserves of those banks in 1982 to 43 percent in 1984. For the Nation as a whole, this relationship declined from 54 percent of capital and reserves in 1982 to 47 percent in 1984.

Keeping in mind that 30 percent of the Nation's banks are considered agricultural banks, at year end 1984 37 percent of the

banks on the FDIC's problem bank list were considered agricultural banks and 38 percent of the banks which failed in 1984 were agricultural banks.

Twenty-nine agricultural banks failed in 1984 and three have closed thus far this year. Of these 32 bank failures, 47 percent was caused by obvious weak management and poor lending practices, 31 percent was caused by abusive insider transactions, fraud or irregular activities by management, 9 percent was the result of gross mismanagement and 13 percent was due to either out-of-territorial lending, broker deposits or speculative lending in real estate and energy investments.

With respect to what the FDIC is doing to help relieve these financial difficulities, we believe that we can best help in that effort by exercising our statutory responsibility of protecting depositors and maintaining confidence in the banking system. This we attempt to do by fair and objective bank examinations and the use of remedial programs to help strengthen banks which begin to show signs of weakness.

I would like to point out that over 81 percent of the agricultural banks which have failed since the beginning of 1984 were handled by purchase and assumption transactions, thus keeping banking services and facilities in the affected communities and providing an injection of millions of dollars into those areas which the buying bank can then use to fund loans in the community.

Additionally, in the past year and a half the FDIC has expedited deposit insurance protection for 41 institutions in several Farm Belt States to stem fears that developed when several uninsured institutions in those States failed leaving their uninsured depositors with virtually no hope for recovery.

Thank you.

Senator PRESSLER. Thank you very much.

[The prepared statement of Mr. Thacker follows:]

STATEMENT ON

FARM CREDIT PROBLEMS
AND THEIR IMPACT ON AGRICULTURAL BANKS

PRESENTED TO

COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON FAMILY FARM
UNITED STATES SENATE

BY

CHARLES E. THACKER
ASSOCIATE DIRECTOR, DIVISION OF BANK SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

2:00 p.m.
Thursday, February 7, 1985
Room 428A, Russell Senate Office Building

Mr. Chairman, and members of the subcommittee, my name is Charles E. Thacker. I am an Associate Director of the Division of Bank Supervision of the Federal Deposit Insurance Corporation. FDIC is a Federally chartered insurance company responsible for insuring depositors against loss, up to $100,000, of their deposits in the event of a bank failure. The FDIC is funded by insurance premiums charged to insured institutions and by the interest income on our investments in Treasury obligations. To control the risk to the insurance fund, the FDIC regulates and supervises the activities of insured institutions and in the event one fails, liquidates the assets acquired as a result of the failure for the benefit of any uninsured depositors, other creditors, and stockholders.

My statement addresses the overall condition of the agricultural banks, our regulatory responsibilities and our liquidation activities.

In recent times specific industries, particularly energy and real estate, have suffered severe losses which have been the principal cause of some commercial bank failures. Insofar as agricultural banks are concerned, we have yet to see an agricultural bank fail solely because of the condition of the agricultural economy.

However, there are substantial volumes of classified loans in many agricultural banks, so it remains to be seen the extent to which the losses inherent in these classifications will threaten the solvency of agricultural banks. Today we will take a look at agricultural banks from a performance standpoint and then discuss the FDIC's role in this industry.

Probably the best place to start the discussion is to agree on a definition for an agricultural bank. We have defined an agricultural bank as one in which agricultural loans comprise 25 percent or more of total loans. Agricultural loans are defined as loans secured by farmland, loans to finance agricultural production, and other loans to farmers. Using this definition, almost 30% of the commercial banks in the U.S., or 4,146 banks, are

agricultural banks. These banks are spread throughout 39 states, however, Iowa, Illinois, Kansas, Minnesota, Nebraska and Missouri have heavy concentrations of agricultural banks. The number of agricultural banks in these six states alone accounts for 60% of the agricultural banks in the U.S.

Of the funds lent to farmers by major institutional lenders, Commercial banks provide about 40 percent of total farm operating loans and 10 percent of total farm real estate loans. However, they provide less than 30% of total farm loans, with the Farm Credit System the largest lender, holding 41.3% of farm debt. Within the banking industry, numerous banks are heavily concentrated in agricultural loans. Over one-half of the banks, or 2,935 banks, in a 16 state comparison comprised of midwest and plains states had a ratio of agricultural loans to total loans in excess of 30%, while this ratio exceeded 50% in one quarter of the banks in those 16 states. At least 70% of the banks in the states of South Dakota and Nebraska have more than 50% of their total loan portfolio tied up in agricultural credits. Other states such as Iowa and North Dakota are not far behind. Naturally, financial stress in the

agricultural industry leads to questions about the conditions of these banks and forces the FDIC to upgrade its surveillance and supervisory efforts.

During much of the 1970s, agricultural banks typically outperformed other small banks. Return on Equity and Return on Assets were generally higher, while the loan loss rate for agricultural banks was consistently lower. With increasing pressure on agricultural banks due to high interest rates and low commodity prices for farmers, which brought about declines in land values, this has not carried over into the 1980s. Loan loss rates at agricultural banks increased from 0.3 percent in 1980 to 0.9 percent in 1983, surpassing loss rates at other small banks which rose from 0.4 percent to 0.7 percent, respectively. At the same time, the Return on Equity differential between agricultural and other small banks disappeared by 1983, while Return on Assets has declined, but has managed to remain higher than the nonagricultural banks.

This trend has continued throughout 1984. In comparing agricultural banks against a like number of other banks in each of 16 states, we see that, in

general, agricultural banks are more highly capitalized than their nonagricultural counterparts, and as such are in a better position to withstand loan losses. Large increases in the provision for loan losses account for this higher capital position. Capital ratios increased from 9.0 percent in 1980 to 9.2 percent at year-end 1983 while the provision for loan losses as a percent of total loans increased from 0.4 percent to 1.1 percent during the same period. These trends have also continued in 1984. While this puts agricultural banks in a better position to deal with loan losses, the potential for losses has also increased.

Several other trends are evident in the 16 state comparison. Agricultural banks have a higher percentage of loans in past due status and in nonaccrual and renegotiated status than do their nonagricultural counterparts. This may be indicative of the severity of the problems in some of the loans at the agricultural banks. Also, agricultural banks generally exhibit lower loan to asset ratios than do the nonagricultural banks. In fact, a general decline in loan to asset ratios has taken place since late 1979 and can be attributed to

the decline in the growth rate of farm loans while deposit growth has continued at relatively high rates. This has left agricultural banks with funds to lend, but considerable doubt about the ability of the agricultural producers to service the debt. Of note, however, is that the general decline in loan to asset ratios began to reverse itself in late 1983 and an increasing trend was noted through 1984. This is indicative of the growing inability of farmers to pay down debt rather than growth in farm loans.

Surprisingly, agricultural banks have not suffered huge losses in earnings. As a matter of fact, most of the net interest margins at agricultural banks are in line with their state average while the nonagricultural banks are the ones that fall far short of the state average. It appears that the agricultural banks have been able to maintain strong yields on their assets and keep the cost of funds at a minimum. Whether or not this trend will continue if agricultural credits deteriorate further is uncertain.

Despite the better performance of agricultural banks on an historical basis, many agricultural banks, recognizing that problems were developing, have prepared themselves for this situation and have so far been able to handle the problems easier than they have in the past. Their customers, the farmers who borrowed through the inflationary period just past, and now are suffering from declining land values and crop prices, must provide their bankers with accurate statements of their position in order for the situation to be worked out. Too often lending decisions are based on character, not supporting statements. While the statements may not be pretty, they are the first step toward a workout of agricultural credits.

There is no doubt that many farms are facing a cash flow crisis. This is especially true of a small percentage of farmers. Figures from a recent Federal Reserve Board study show that 8 percent of the farmers that hold 31 percent of the agricultural debt have debt-to-assets ratios of greater than 70 percent. It is simply unrealistic to expect a number of these farmers to generate sufficient cash flow from operations to service their obligations.

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To compound the difficulties of some farmers, balloon payments on short-term land contracts are now coming due. Losses seem inevitable, especially on loans against the security of land values that have declined sharply.

The historical performance trends for agricultural banks are cold comfort for the problems besetting these banks. A quick run down of recent problem and failed bank statistics may give a truer perspective on agricultural banks. Remember that agricultural banks represent 30% of the total banks in the country. At year-end 1982 and through 1983 agricultural banks were 20-24% of the total number of problem banks. By June 1984, however, these banks represented 34% of the total and now represent about 37% of all problem banks. A similar situation is found when looking at failed bank statistics. For the first eight months of 1984, agricultural banks represented only 24% of the total failed banks; for the whole year, agricultural bank failures were 38% of the total; However, for the last four months of 1984, agricultural banks were 71% of the failed banks.

Having just discussed the numbers of problem and failed banks, let me talk about what the FDIC tries to do with problem banks, and how we handle the failures. When institutions present the warning signs associated with a problem institution, or are in danger of becoming insolvent, the FDIC will respond as it does to any bank in this situation, whether the problem stems from agricultural credits, real estate credits, energy credits or otherwise. We increase the number and frequency of our visits or examinations, and off-site reviews and surveillance are more frequent. Formal or informal administrative actions may be initiated. If efforts to turn the situation around are not successful, and the chartering authority decides to close the institution, the FDIC may be forced into its role as receiver and try to arrange a purchase and assumption, or if necessary, pay off depositors.

By supervising problem banks closely the FDIC can provide a sound appraisal of agricultural credits and recommendations to management as to possible courses of action. Whether to curtail credit lines, restructure, forebear or foreclose, and when to do so, and with respect to which borrowers, are bank

management decisions that should be made with a view towards minimizing losses to all concerned. The FDIC will look at each loan individually, pointing out weaknesses, as appropriate, for management's attention. We will also consider the collectability of a bank's entire portfolio in the context of the overall condition of the bank. Certainly, we are receptive to a showing by any bank management that they are working with their agricultural borrowers and doing all that can be done reasonably under the circumstances to run a sound and profitable bank.

Given the recent acceleration of agricultural bank failures, you are rightly concerned with how the FDIC handles the assets from such failures. Our policies are clear and are mandated by law. The FDIC, as a fiduciary for the creditors and shareholders of failed banks, is charged with the responsibility to maximize the recoveries on the assets of failed banks. As much as we might like to do so, the FDIC cannot become a grant-type agency. That would be contrary to our legal responsibilities and could easily erode the strength of our insurance fund, which is performing a critical role in maintaining

confidence and stability in the banking system. Normally, the best way for the FDIC to maximize the return on the assets of failed banks is to work with the borrowers. Foreclosure is viewed as a last resort, though it becomes necessary when a borrower is not observing sound business practices, is too deeply in debt to have any potential for recovery, or will not participate in a suitable workout program. The proceeds from the sales or recoveries of failed bank assets are disbursed as quickly as possible.

The FDIC has provided assistance to several states to speed up the liquidation process to provide funds to communities affected by the failure of banks that were not Federally insured banks. You may also be aware that we have expedited the approval process for deposit insurance applications of non-insured operating institutions in a number of states as a means of supporting the publics' confidence in these banks.

When all supervisory efforts have been exhausted, and the bank is declared insolvent by its chartering authority, and we are named as receiver, we

attempt to handle the failure in the quickest and least disruptive manner possible. Agricultural bank failures have primarily been handled through purchase and assumptions transactions. This technique is one where an existing strong bank acquires the sound assets and the deposits of a failed bank, with the FDIC providing cash to make up the difference between asset values and liabilities. P & A transactions, as they are called, preserve bank services in communities and minimize the economic disruption caused by bank failures.

In the longer term, there is little that the FDIC can, by itself, do to alleviate the agricultural credit problem. We will continue our policy of realistic and fair evaluations of farm credits and assist in any way allowed by our statuatory limitations to produce a recovery in the farm sector.

While the FDIC is limited in its powers and policies in how it may assist the farmers and problem or failed banks in this country, the states do have avenues open for assistance. Many state laws restrict the opening and

expansion of banks in their states. Changes in the branching laws and holding company laws could ease the pressure on banks. Several regions of the country are experimenting with regional interstate banking compacts. While the process of getting various state legislatures to pass comparable interstate banking laws is cumbersome, the benefits of diversifying funding and lending opportunities may make this effort worthwile. Other state laws which prohibit ownership of land by corporations, for example, or which exact a punitive tax penalty on the conversion of agricultural land to nonagricultural purposes, restrict the entering and exiting of persons from the agricultural industry. States should attempt to assure that the benefits of these laws truly exist and that the costs of such restrictions do not exceed such benefits.

A recent proposal from a Midwestern Congressman presents another alternative for dealing with loans that are taken over by the FDIC in a failing bank situation. Under this scenario, certain loans that are not assumed by the surviving institution could be purchased by an agency and therefore prevent "borderline" agricultural loans from undergoing probable liquidation. Funding

seems to be the major issue in this debate, as well as whether the funding agency should be state or Federal. Here again, state laws also enter into the picture due to prohibitions on the use of public funds for private purposes.

In sum, the FDIC is acutely aware of, and sympathetic to, the agricultural crisis. We are exploring alternatives that will not detract from our private enterprise system, or erode confidence in the banking system.

Attached are schedules showing performance characteristics of agricultural and non-agricultural banks in 16 midwest and plains states containing almost three-fourths of the nation's agricultural banks and the relationship of problem banks to total banks in these states as well as the entire country.

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
16 STATE AVG	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	4.2	4.2	3.7	0.0	0.0	0.0	4.2	3.8	3.6
NONACC & REN	0.0	0.0	0.0	1.1	1.7	2.3	0.0	0.0	0.0	1.4	1.5	1.8
CAPITAL RATIO	8.8	9.0	9.0	9.2	9.2	9.6	8.3	8.5	8.2	8.0	8.2	8.5
LOANS/ASSETS	58.5	53.7	52.0	51.8	51.9	55.0	57.8	54.0	52.3	52.3	53.9	57.6
ROA	1.31	1.42	1.34	1.20	1.05	1.00	1.06	1.07	1.03	0.86	0.74	0.89
NIM	5.47	5.40	5.59	5.53	5.36	5.04	5.84	6.74	5.62	5.55	5.38	5.29
					NIM AVG	5.37					NIM AVG	5.73

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
COLORADO	1979	1980	1981	1982	1983	9/84	19/9	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	4.3	4.6	4.5	0.0	0.0	0.0	4.0	3.5	3.2
NONACC & REN	0.0	0.0	0.0	1.7	2.5	3.1	0.0	0.0	0.0	1.6	1.9	2.2
CAPITAL RATIO	9.8	10.0	9.8	10.4	9.9	10.3	9.0	9.4	8.2	7.9	8.3	8.7
LOANS/ASSETS	61.7	58.4	57.6	58.4	58.6	59.8	60.6	56.2	58.7	56.0	56.2	58
ROA	1.64	1.73	1.30	1.08	0.99	0.76	1.49	1.61	1.52	0.99	1.18	1.00
NIM	6.33	6.55	6.56	6.42	6.02	5.88	6.83	7.04	7.40	7.08	6.74	6.84
					NIM AVG	6.29					NIM AVG	6.99

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
IDAHO	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	5.0	4.7	3.0	0.0	0.0	0.0	3.7	4.0	2.5
NONACC & REN	0.0	0.0	0.0	2.4	2.7	3.1	0.0	0.0	0.0	1.6	1.4	1.2
CAPITAL RATIO	7.7	8.0	8.1	8.6	8.7	8.9	8.3	9.0	8.1	6.9	6.8	6.7
LOANS/ASSETS	62.1	58.4	59.0	57.3	58.4	62.6	57.2	56.6	56.4	59.1	58.3	65.7
ROA	1.13	1.12	1.14	0.96	0.99	1.07	1.28	1.20	0.69	0.52	0.50	0.72
NIM	6.09	5.58	5.94	6.02	6.01	5.39	6.82	6.52	6.03	5.71	5.70	5.34
					NIM AVG	5.84					NIM AVG	6.02

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
ILLINOIS	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	3.4	3.2	3.2	0.0	0.0	0.0	4.1	3.4	2.4
NONACC & REN	0.0	0.0	0.0	0.7	1.1	1.4	0.0	0.0	0.0	1.7	1.7	1.7
CAPITAL RATIO	9.2	9.3	9.3	9.4	9.5	9.9	8.5	8.6	7.1	7.4	7.3	7.6
LOANS/ASSETS	54.7	49.2	46.2	44.5	45.3	49.0	54.1	50.0	48.8	48.7	46.7	50.0
ROA	1.26	1.25	1.21	1.16	1.12	1.05	0.88	0.82	0.83	0.71	0.73	1.05
NIM	4.97	4.83	4.94	4.96	4.96	4.66	5.10	4.89	4.90	4.77	4.84	4.82
					NIM AVG	4.89					NIM AVG	4.89

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
INDIANA	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	3.9	3.7	3.4	0.0	0.0	0.0	3.4	3.6	1.9
NONACC & REN	0.0	0.0	0.0	0.9	1.0	1.5	0.0	0.0	0.0	1.2	1.3	1.2
CAPITAL RATIO	9.1	9.3	9.5	9.3	9.2	9.4	8.3	8.5	8.5	8.3	8.1	7.2
LOANS/ASSETS	58.2	54.5	52.4	50.4	49.1	54.0	55.9	52.2	51.5	51.3	47.6	56.9
ROA	1.21	1.19	0.98	0.74	0.79	0.94	1.06	1.01	0.73	0.65	0.67	0.92
NIM	5.19	4.74	4.51	4.35	4.53	4.50	5.14	4.83	4.59	4.33	4.39	4.52
					NIM AVG	4.64					NIM AVG	4.63

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
IOWA	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	3.2	3.3	3.2	0.0	0.0	0.0	3.5	2.8	2.8
NONACC & REN	0.0	0.0	0.0	0.8	1.6	2.3	0.0	0.0	0.0	1.8	1.3	1.5
CAPITAL RATIO	8.6	8.9	9.0	9.0	9.2	9.6	8.2	8.1	8.0	7.3	7.8	8.6
LOANS/ASSETS	60.7	53.6	49.4	48.4	47.4	51.6	57.4	51.0	46.4	44.5	47.1	49.5
ROA	1.26	1.42	1.35	1.18	1.09	0.81	0.93	1.04	0.98	0.74	0.69	0.74
NIM	4.79	5.01	5.18	4.94	4.87	4.55	5.01	4.98	4.90	4.78	4.74	4.69
					NIM AVG	4.89					NIM AVG	4.85

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
KANSAS	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	2.8	3.1	3.3	0.0	0.0	0.0	3.9	3.6	3.5
NONACC & REN	0.0	0.0	0.0	0.6	1.1	2.2	0.0	0.0	0.0	0.9	1.4	1.5
CAPITAL RATIO	9.0	9.2	9.2	9.4	9.6	10.1	8.5	8.5	8.5	8.4	8.5	8.7
LOANS/ASSETS	55.6	51.0	48.8	49.3	49.7	51.2	54.3	51.8	49.4	49.2	51.8	54.7
ROA	1.31	1.39	1.41	1.29	1.03	0.88	0.99	1.04	1.00	0.98	0.80	0.74
NIM	5.21	5.41	5.77	5.63	5.38	5.00	5.21	5.31	5.41	5.52	5.33	5.14
					NIM AVG	5.40					NIM AVG	5.32

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
MICHIGAN	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	4.4	5.4	3.9	0.0	0.0	0.0	5.6	5.1	4.6
NONACC & REN	0.0	0.0	0.0	1.4	1.8	2.4	0.0	0.0	0.0	0.9	1.9	1.8
CAPITAL RATIO	8.7	8.9	8.4	8.9	8.6	8.5	8.6	8.7	8.4	8.3	8.2	8.5
LOANS/ASSETS	61.3	56.1	53.5	55.5	56	60	60.6	57.2	56.7	51.4	50.6	55.3
ROA	1.09	1.14	0.82	0.89	0.9	0.52	1.04	0.86	0.80	0.89	0.68	0.77
NIM	5.94	4.70	4.62	4.95	4.67	4.31	6.41	4.56	4.69	4.86	4.86	4.86
					NIM AVG	4.87					NIM AVG	5.04

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
MINNESOTA	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	4.1	4.3	4.0	0.0	0.0	0.0	4.6	4.0	3.7
NONACC & REN	0.0	0.0	0.0	0.8	1.2	1.8	0.0	0.0	0.0	0.8	1.1	1.4
CAPITAL RATIO	8.2	8.4	8.6	8.9	9.0	9.6	7.8	8.0	8.2	8.2	8.0	8.5
LOANS/ASSETS	61.3	54.1	52.3	53.6	53.5	58.1	61.1	57.2	55.4	56.0	54.9	57.5
ROA	1.16	1.28	1.32	1.2	1.04	1.07	0.90	0.84	0.83	0.67	0.8	0.98
NIM	4.66	5.00	5.31	5.25	5.1	4.89	5.25	5.13	5.35	5.25	5.30	5.26
					NIM AVG	5.04					NIM AVG	5.26

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
MISSOURI	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	4.3	3.7	3.5	0.0	0.0	0.0	4.0	3.3	2.8
NONACC & REN	0.0	0.0	0.0	1.0	1.7	2.7	0.0	0.0	0.0	1.0	1.0	1.3
CAPITAL RATIO	9.0	9.2	9.3	9.5	9.4	9.8	8.8	8.9	8.7	8.6	8.6	8.7
LOANS/ASSETS	55.3	51.3	49.3	48.6	49.2	52.2	56.0	52.9	50.7	49.9	49.4	52.3
ROA	1.37	1.36	1.32	1.23	0.74	0.63	0.97	0.98	0.95	0.88	0.33	0.66
NIM	5.36	5.34	5.57	5.51	5.06	4.77	5.49	5.29	5.43	5.37	5.09	5.01
					NIM AVG	5.27					NIM AVG	5.28

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
MONTANA	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	5.3	5.6	4.3	0.0	0.0	0.0	6.1	5.2	5.9
NONACC & REN	0.0	0.0	0.0	0.8	1.8	3.1	0.0	0.0	0.0	1.1	1.5	2.2
CAPITAL RATIO	8.5	8.6	8.8	8.8	8.5	9.3	7.6	7.9	8.0	8.4	7.7	8.5
LOANS/ASSETS	56.8	50.6	50.6	50.2	50.1	53.9	62.5	57.3	55.6	57.9	56.9	61.0
ROA	1.40	1.49	1.45	1.27	1.49	1.4	1.12	1.05	1.13	1.12	1.1	1.19
NIM	6.03	5.40	5.49	5.65	5.7	5.34	6.48	5.62	5.65	6.07	5.97	6.05
					NIM AVG	5.60					NIM AVG	5.97

	AGRICULTURAL BANKS						NON-AGRICULTURAL BANKS					
NEBRASKA	1979	1980	1981	1982	1983	9/84	1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	2.6	2.9	2.6	0.0	0.0	0.0	2.4	2.0	2.4
NONACC & REN	0.0	0.0	0.0	1.0	1.7	2.3	0.0	0.0	0.0	1.6	1.8	2.4
CAPITAL RATIO	9.0	9.3	9.5	9.3	9.6	10.1	7.0	7.1	7.2	7.1	7.8	8.4
LOANS/ASSETS	59.3	55.7	54.1	54.0	54.2	58.0	52.2	45.5	44.4	44.8	51.4	59.7
ROA	1.47	1.78	1.73	1.44	1.16	1.10	1.05	1.14	1.05	0.78	0.41	0.69
NIM	5.39	6.02	6.30	6.07	5.66	5.21	5.73	6.00	6.22	5.84	5.43	5.34
					NIM AVG	5.76					NIM AVG	5.76

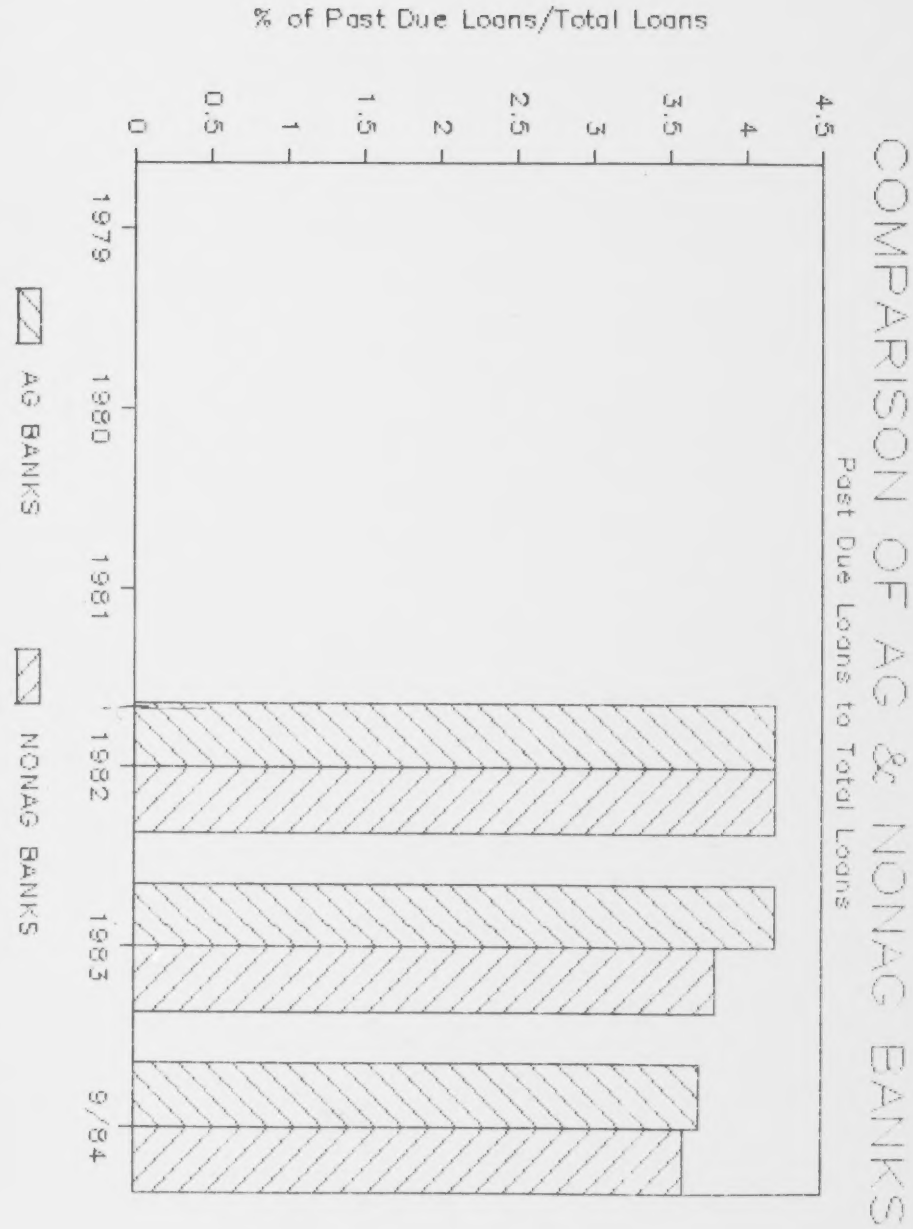
NORTH DAKOTA	AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84	NON-AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	5.3	5.3	3.7	0.0	0.0	0.0	4.0	3.4	3.7
NONACC & REN	0.0	0.0	0.0	1.0	1.6	2.5	0.0	0.0	0.0	2.0	1.8	2.4
CAPITAL RATIO	9.0	9.1	8.8	8.8	9.0	9.6	8.2	8.8	8.5	8.0	7.7	8.2
LOANS/ASSETS	58.3	51.8	48.2	48.5	48.1	50.8	57.9	54.2	49.0	49.5	52.6	55.5
ROA	1.35	1.45	1.46	1.21	1.09	1.25	0.95	0.86	0.79	0.78	0.72	1.04
NIM	5.08	5.37	5.72	5.55	5.18	5.06	5.21	5.33	5.33	5.42	5.06	5.06
					NIM AVG	5.33					NIM AVG	5.24

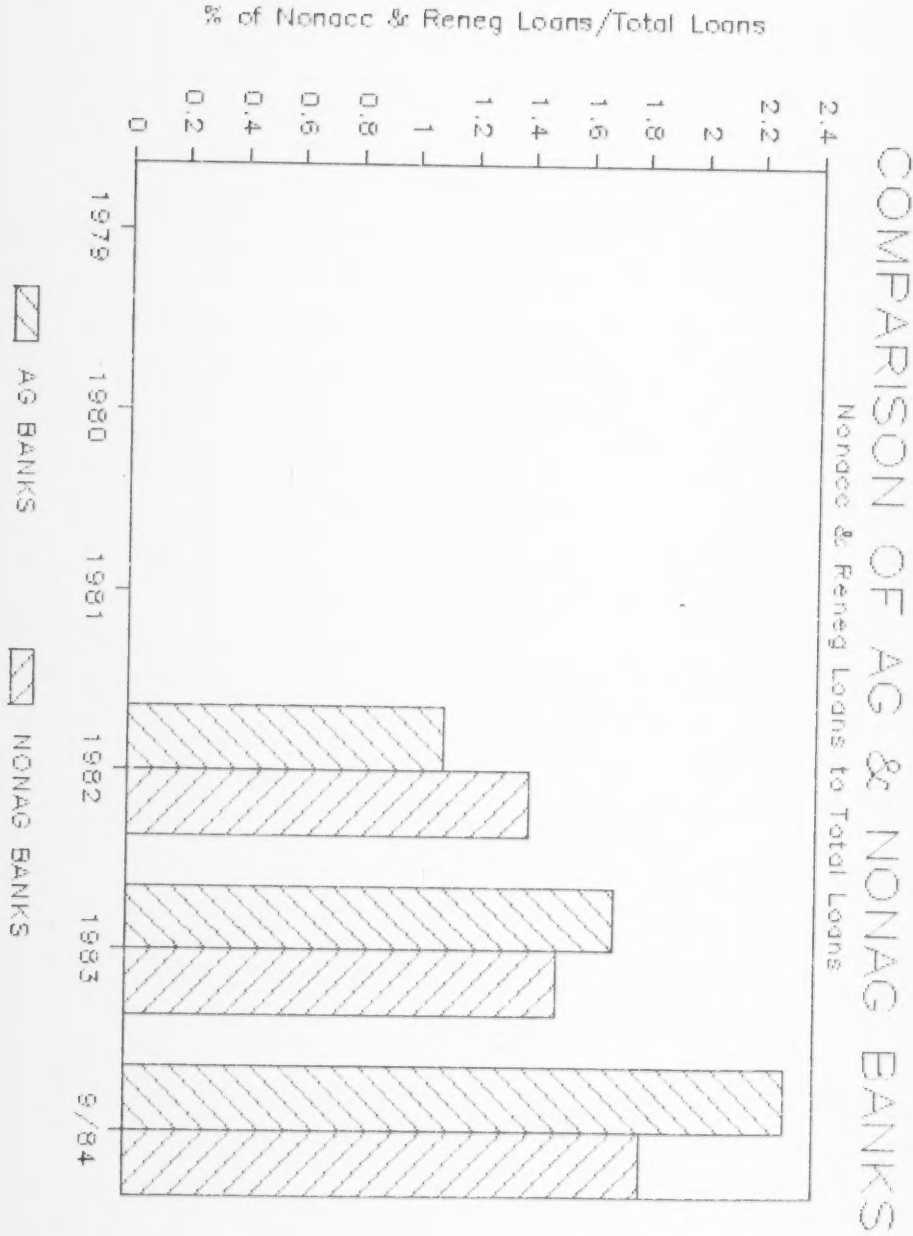
OKLAHOMA	AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84	NON-AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	3.4	4.2	4.4	0.0	0.0	0.0	4.0	4.7	4.4
NONACC & REN	0.0	0.0	0.0	1.1	1.8	2.7	0.0	0.0	0.0	1.2	1.9	2.3
CAPITAL RATIO	8.9	9.1	8.9	9.2	9.8	9.9	8.8	8.9	8.8	8.6	8.6	9.2
LOANS/ASSETS	51.8	49.0	49.4	49.7	49.3	47.3	54.5	51.1	50.3	54.3	51.0	51.5
ROA	1.58	1.71	1.71	1.56	1.00	0.98	1.23	1.30	1.53	1.00	0.80	1.10
NIM	6.27	6.15	6.33	6.13	5.86	5.42	6.29	6.28	6.47	6.45	6.10	5.82
					NIM AVG	6.03					NIM AVG	6.24

SOUTH DAKOTA	AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84	NON-AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	3.3	3.1	2.9	0.0	0.0	0.0	4.1	3.3	3.3
NONACC & REN	0.0	0.0	0.0	1.3	2.4	3.0	0.0	0.0	0.0	2.2	0.4	0.4
CAPITAL RATIO	8.0	8.2	8.4	8.5	8.1	8.7	7.5	7.7	7.2	6.8	10.6	10.1
LOANS/ASSETS	62.0	56.2	53.3	52.8	54.6	57.9	63.5	60.6	56.7	57.4	83.5	88.6
ROA	1.12	1.41	1.39	1.24	1.18	1.28	0.66	0.83	0.85	0.45	0.29	0.78
NIM	4.91	5.28	5.68	5.41	5.40	5.18	6.14	5.27	5.63	5.29	5.43	5.14
					NIM AVG	5.31					NIM AVG	5.48

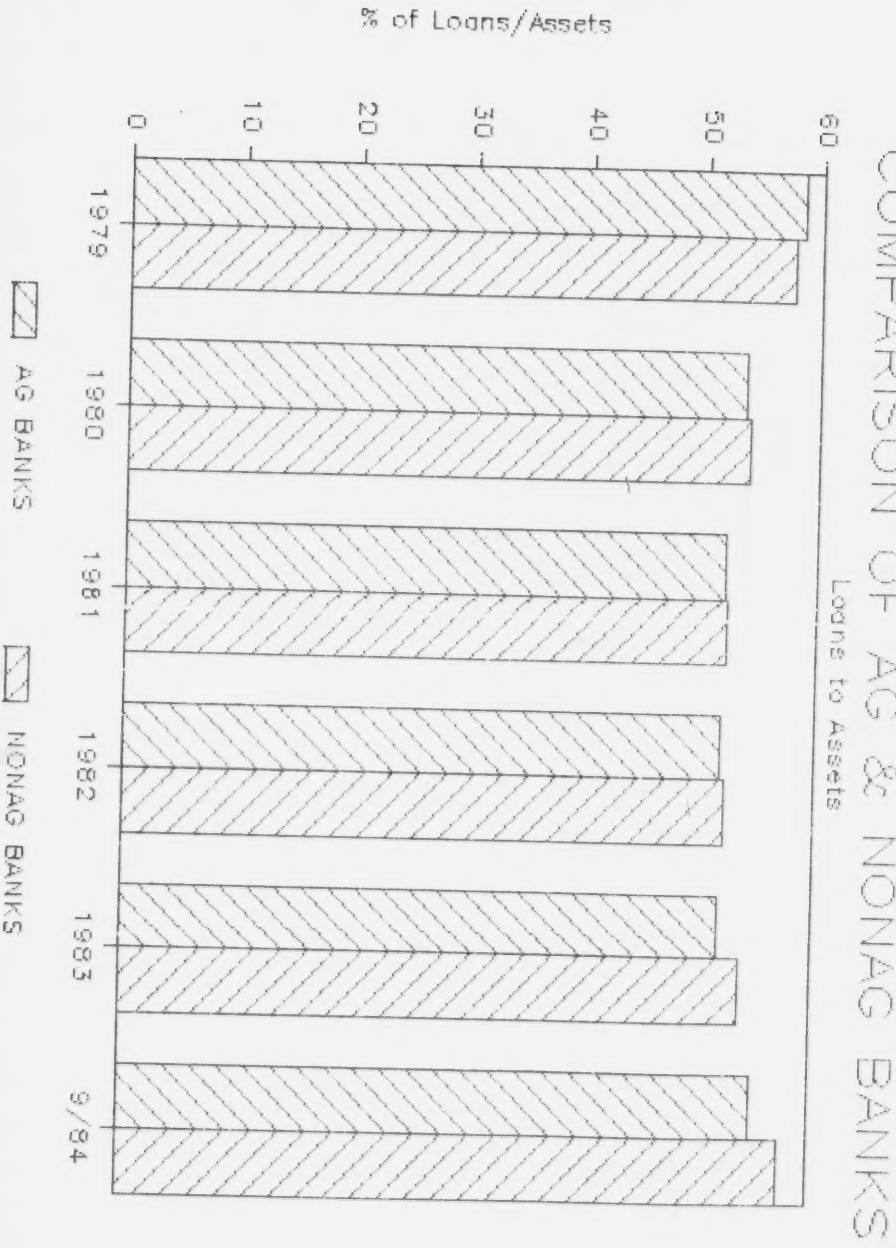
WISCONSIN	AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84	NON-AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	5.4	5.4	4.8	0.0	0.0	0.0	4.8	3.9	3.7
NONACC & REN	0.0	0.0	0.0	0.6	1.0	1.6	0.0	0.0	0.0	1.3	1.2	1.2
CAPITAL RATIO	8.6	9.0	9.1	9.3	9.5	9.8	8.3	8.6	8.8	8.7	8.7	9.1
LOANS/ASSETS	62.3	58.9	56.6	54.9	55.0	58.1	61.7	59.1	56.5	54.3	52.3	56.0
ROA	1.17	1.22	1.24	1.21	1.05	1.00	0.95	0.94	0.97	0.84	0.94	1.04
NIM	4.62	4.67	4.98	5.17	4.96	4.65	4.77	24.32	5.17	5.12	5.13	4.98
					NIM AVG	4.84					NIM AVG	8.25

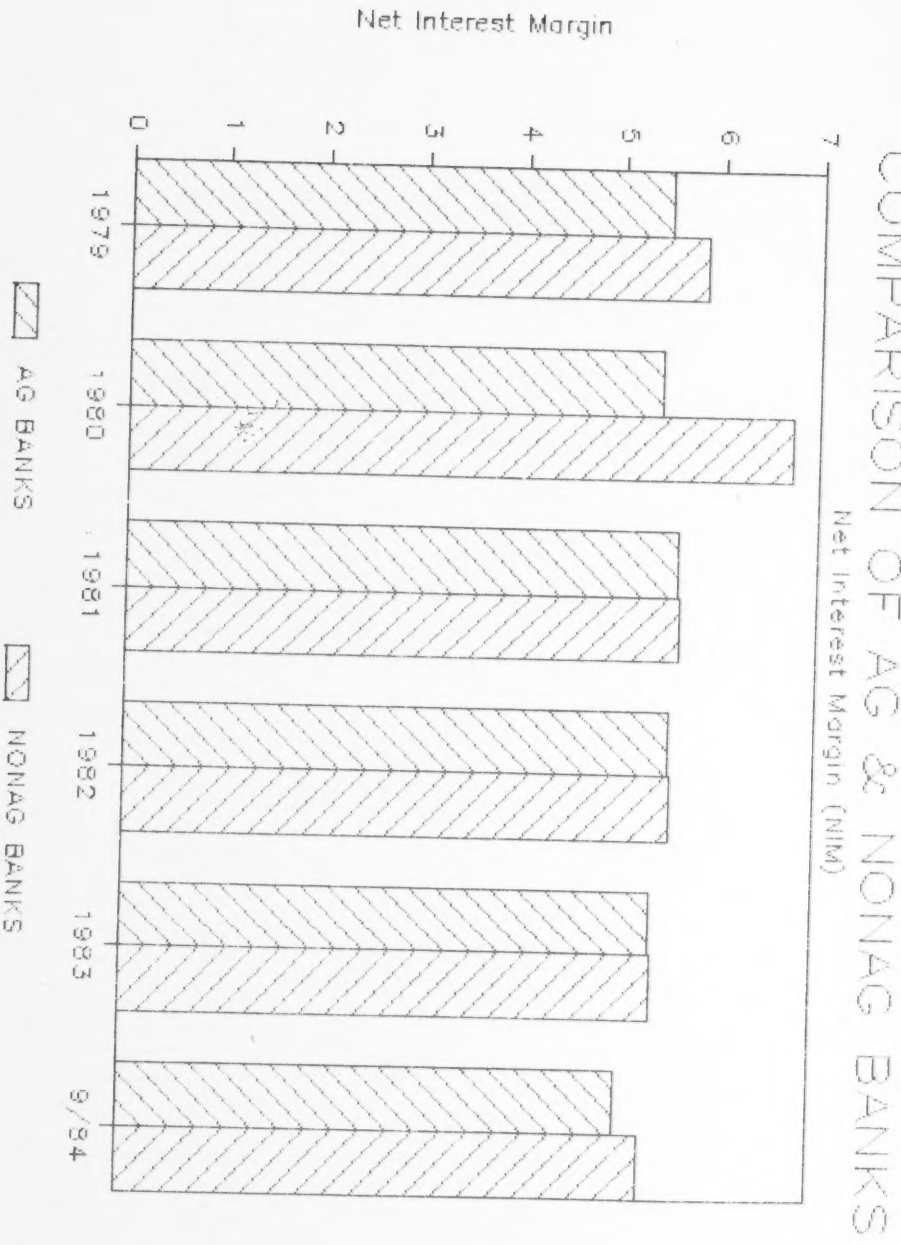
WYOMING	AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84	NON-AGRICULTURAL BANKS 1979	1980	1981	1982	1983	9/84
PAST DUE LOAN	0.0	0.0	0.0	6.6	4.8	4.5	0.0	0.0	0.0	5.3	4.5	6.0
NONACC & REN	0.0	0.0	0.0	2.0	1.4	1.8	0.0	0.0	0.0	1.1	2.5	4.1
CAPITAL RATIO	9.1	9.6	9.8	9.7	10.0	10.4	8.6	9.0	9.3	9.7	8.9	9.4
LOANS/ASSETS	54.5	51.0	51.4	52.6	52.6	55.1	55.8	50.9	49.9	52.9	52.2	49.9
ROA	1.42	1.75	1.62	1.46	1.12	1.30	1.48	1.60	1.78	1.70	1.17	0.74
NIM	6.62	6.33	6.58	6.47	6.42	5.86	7.55	6.43	6.82	6.92	5.95	5.81
					NIM AVG	6.38					NIM AVG	6.58

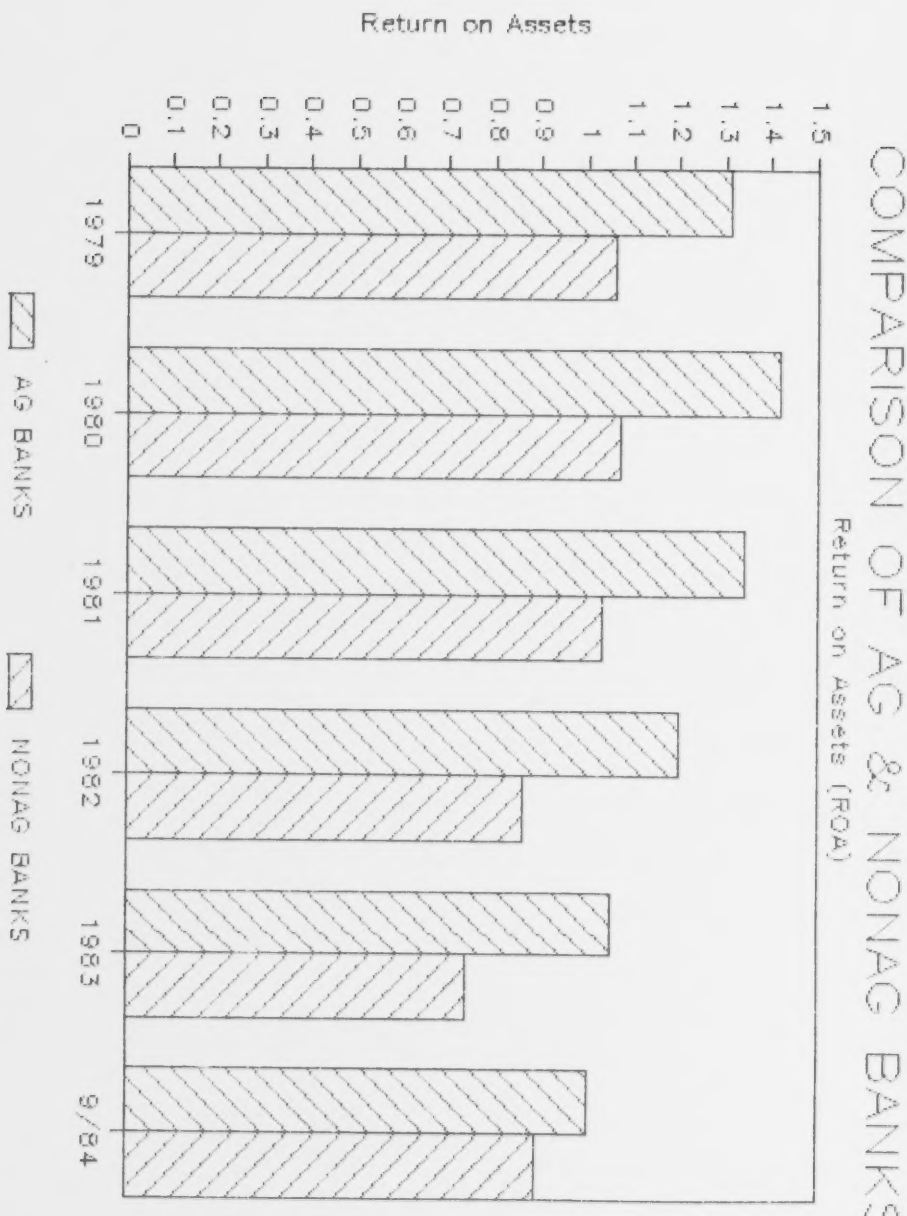

COMPARISON OF AG & NONAG BANKS
Past Due Loans to Total Loans
% of Past Due Loans/Total Loans
0
0.5
1
1.5
2
2.5
3
3.5
4
4.5
1979
1980
1981
1982
1983
9/84
AG BANKS
NONAG BANKS


COMPARISON OF AG & NONAG BANKS
Nonacc & Reneg Loans to Total Loans
% of Nonacc & Reneg Loans/Total Loans
0
0.2
0.4
0.6
0.8
1
1.2
1.4
1.6
1.8
2
2.2
2.4
1979
1980
1981
1982
1983
9/84
AG BANKS
NONAG BANKS

COMPARISON OF AG & NONAG BANKS
Capital Ratio
Capital Ratio
0
1
2
3
4
5
6
7
8
9
10
1979
1980
1981
1982
1983
9/84
AG BANKS
NONAG BANKS


COMPARISON OF AG & NONAG BANKS
Loans to Assets
% of Loans/Assets
0
10
20
30
40
50
60
1979
1980
1981
1982
1983
9/84
AG BANKS
NONAG BANKS


COMPARISON OF AG & NONAG BANKS
Net Interest Margin (NIM)
Net Interest Margin
0
1
2
3
4
5
6
7
1979
1980
1981
1982
1983
9/94
AG BANKS
NONAG BANKS


COMPARISON OF AG & NONAG BANKS
Return on Assets (ROA)
Return on Assets
0
0.1
0.2
0.3
0.4
0.5
0.6
0.7
0.8
0.9
1
1.1
1.2
1.3
1.4
1.5
1979
1980
1981
1982
1983
9/84
AG BANKS
NONAG BANKS

AGRICULTURAL BANKING SITUATIONS

We have defined an agricultural bank as one in which agricultural loans comprise 25 percent or more of total loans. Using this definition, almost 30% of the commercial banks in the United States, or 4,146 banks, are agricultural banks. These banks are spread throughout 39 states; however, Iowa, Illinois, Kansas, Minnesota, Nebraska and Missouri have heavy concentrations of agricultural banks. The number of agricultural banks in these six states alone accounts of 60% of the agricultural banks in the United States.

Over one-half of the banks, or 2,935 banks, in a 16-state comparison comprised of midwest and plains states, had a ratio of agricultural loans to total loans in excess of 30%, while this ratio exceeded 50% in one-quarter of the banks in those 16 states.

	% of Problem Banks to Total Banks
Nationwide	5.8
Colorado	7.5
Nebraska	7.8
Iowa	7.8
North Dakota	5.1
Kansas	6.7
South Dakota	6.3
Montana (only 167 banks)	9.6
Idaho	8.0
Wyoming	5.2
Minnesota	5.1
Missouri	6.4
Indiana	5.5
Illinois	4.4
Michigan	3.3
Oklahoma	9.6
Wisconsin	5.5
Composite ratio for above 16 states	6.1

Senator PRESSLER. Mr. Wilkinson, had you nearly completed? Why don't you finish up.

STATEMENT OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION—Continued

Mr. WILKINSON. May I just make one or two additional comments?

Senator PRESSLER. OK, great.

Mr. WILKINSON. It is fortunate that this did happen. Mr. Thacker explained the FDIC concept, and one of the recommendations that we would have for you is that that self-insurance concept be considered for the farm credit system.

Even now under the authority of the Farm Credit Act there is the revolving fund which the Governor may use, but not for situations such as we find prevalent now. This fund could be used as the basis of the beginning of an insurance program for the farm credit system loss sharing protection plans.

The additional recommendation which we would have would speak to the capability of the system as authorized by Congress to restructure itself so that its total capital base would be available in providing assistance. And, finally, that our own administration's enforcement powers be enhanced quite similar to those of the Comptroller, the FDIC, and the other financial regulators. We have never had that particular type of authority. We would refer to it as intermediate authority. We do have the ability to sever funding, but that is a last resort type of enforcement activity.

Finally, one of your questions I think has been and will be are these financial institutions doing everything they can to stay with the farmers of their community.

As Mr. Thacker was reviewing the reason for the financial defaults in the commercial banking industry, I was reviewing those in the farm credit system. And one of the major reasons is that as farmer-owned institutions, they do believe in forbearance.

In one district 8 production credit associations have been liquidated because they stayed too long with borrowers facing too much difficulty and now an actual bank is being endangered. The system has the capability of financially serving that bank, but this is where the farm credit system is today, sir.

Senator PRESSLER. Thank you.

[The prepared statement of Mr. Wilkinson follows:]

STATEMENT OF

DONALD E. WILKINSON, GOVERNOR
FARM CREDIT ADMINISTRATION
February 7, 1985

I. CONDITION OF THE FARM CREDIT SYSTEM

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to appear before you to address the pressing problems facing agriculture and the agricutural finance industry. This is a time of severe stress in agriculture. The adversity that has beset agriculture these past five years has taken its toll not only on the farmers and ranchers who have been forced out of business, but on the private financial institutions that serve them.

I have just returned from a series of meetings with officers and directors of several production credit associations and federal land bank associations of the Farm Credit System to explore ways to improve cooperation between the Farm Credit System and the Farmers Home Administration. Later in my testimony, I will share with you concerns about present FmHA programs and provide some specific recommendations that we believe may help bridge the present adversity in agriculture for a portion of those highly leveraged borowers who show some prospects for returning to productivity.

But first, as governor of the Farm Credit Administration, I will report to you on the financial condition of the private borrower-owned institutions of the Farm Credit System. Today, I can assure you that these institutions are operating on a sound financial basis.

The owners and directors (themselves farmers) of the cooperative lending institutions of the Farm Credit System are often required to make difficult management decisions that can sometimes be heart-wrenching because of their effect on their own friends and neighbours. These tough decisions must be made to preserve the strength and stability of the lending cooperative, thereby enabling it to continue to provide credit service to the majority of its members. Such decisions include merging institutions, consolidating management, intensifying loan servicing efforts, and ultimately foreclosing on borrowers for whom there exists no other alternative.

The institutions of the Farm Credit System have experienced greater loan losses in the past few years than in the entire history of their existence. Last year alone, System institutions had approximately $368 million in loan losses. Nevertheless, I confidently report today, that while a significant volume of non-performing loans is putting financial pressure on some Farm Credit System institutions, its overall capital position remains

strong.

The combined 37 Farm Credit Banks had net loans outstanding of $82.2 billion on September 30, 1984. They reported earnings of $363.1 million for the nine months ended September 30, 1984. For the full year, earnings are expected to be about $437 million. Collectively, the 37 banks of the Farm Credit System have a net worth as of September 30, 1984, of approximately $9.3 billion. Retained earnings and reserves for losses prudently build up over the decades are currently proving sufficient to meet the present challenge.

II. SPOKANE ASSISTANCE

You are well aware of the difficulties in the Twelfth Farm Credit District in Spokane. We have regularly briefed members of the committee and representatives from the Pacific Northwest as matters have developed.

In the past 18 months 8 production credit associations (PCA) have been liquidated in the Spokane District. The law provides that PCAs operate within a ten to one debt/asset ratio. When this ratio is exceeded, when non-performing loans drain reserves, when capital stock is impaired, there is no alternative but to liquidate, either by voluntary action of the PCA's board of

directors or by the FCA. Upon liquidation of a PCA, FCA is mandated to charter neighboring PCAs to continue credit service to creditworthy borrowers. The FICB of Spokane made investments in its PCAs experiencing difficulties. As PCAs have weakened, so too has the FICB weakened.

I am pleased to report to you that earlier this week I approved an interim assistance plan which is the first step of a two part program to bring stability and continued competitive farm credit service to the farmers and ranchers of that region.

The essential facts of the interim assistance and the timetable for completion of the restructuring of the Spokane FICB were provided by letter mailed yesterday to each member of the committee. Let me just point out that the response to this problem clearly demonstrates that the 37 banks of the Farm Credit System recognize their duty as cooperative institutions, and reaffirms their unwavering obligation to stand behind their consolidated debt instruments.

As a financial institution regulatory agency, the FCA has learned many lessons over the past few years. Later in my testimony, I will share with you the results of those lessons because they have great implications as you consider legislative measures to strengthen and improve the nations' agricultural credit delivery system. But first, Mr. Chairman, I would like to provide the

subcommittee with FCA's recommendations for dealing with the immediate crisis facing agriculture.

III. SHORT TERM RECOMMENDATIONS

The Federal Farm Credit Board yesterday adopted a resolution dealing with the stress in agriculture. A copy is attached for the record. I would like to share with you the recommendations we have developed and pledge to you, Mr. Chairman and members of the subcommittee, the FCA's commitment to work with you to craft an appropriate response to today's crisis. We lay no claim of authorship nor profess that these ideas are inviolate. Rather, recognizing the awesome responsibility you shoulder and the magnitude of the problem facing agriculture, we share these ideas and suggestions in the spirit of true cooperation.

Also, as I mentioned at the outset of my testimony, I recently completed a series of meetings with officers and directors of production credit associations and federal land bank associations regarding ways to improve participation in Farmers Home Administration programs by Farm Credit System lenders. I am pleased to report to you my preliminary concerns and recommendations based upon those discussions.

Any response within the next 30 to 60 days to the current crisis must be made through modifications to existing structures and programs. The President's Debt Adjustment Program (DAP) as originally announced offers little or no incentive for private lenders to participate and indeed contains many disincentives for participation, particularly for cooperative lenders.

Local PCA and FLBA boards and association members are adverse to any type of write- down of principal under DAP because that would only be done at their expense in the form of higher interest rates required to make up for the loss of income. In addition, the 110 percent cash flow requirement is excessive and renders the guarantee virtually unnecessary.

Reducing the cash flow requirment to 100 percent, allowing lenders to use the projected sale of a borrower's capital assets to write the loan down to an acceptable cash flow level, and permitting the prospect of recoupment of losses of principal or income once a borrower regains financial stability, would remove many of the present disincentives to participation. In addition, simplifying the requirements of obtaining the guarantee, improving the reliability of payout and shortening FmHA's right of redemption period from one year to three months would also help.

We are particularly concerned that deterioration in elegibility for credit is creating fear that significant numbers of borrowers

may not be able to finance planting operations in the spring of 1985. While the long term solution is not more credit, the current situation is so critical that some emergency credit assistance must again be made available from USDA and be utilized to aid the number of farmers facing foreclosure due to high interest rates coupled with a continuing decline in asset values.

IV. INTERMEDIATE TERM RECOMMENDATIONS

While Farm Credit System institutions remain strongly capitalized, continuing increases in the levels of non-incoming producing assets over an extended period will erode the system's capital base and interest rate competitivness. Investors in Federal Farm Credit Bank Notes and Bonds remain confident in the system for good reason given its prudent level of reserves and continued earning power. Nevertheless, now is time to consider measures to prevent continued increases in non-performing assets from jeopardizing the Farm Credit System's ability to provide loans at the lowest possible rate of interest to America's farmers, ranchers and their cooperatives.

We would like to work with you to develop an emergency Federal mechanism to be used to acquire at book value the non-performing assets of commercial and cooperative lending institutions through direct purchases.

This program would provide a cushion to give farmers and ranchers who are overleveraged and with whom private lenders have reached the limits of forebearance, additional time to attempt to work out their indebtedness. It would also permit private agricultural lenders to eliminate problem loans that drive up effective interest rates to other borrowers.

Clearly, participation in this program should be limited to those institutions whose level of non-performing assets threaten their continued viability. To fund this organization's ongoing loan servicing needs, its should be permitted to subordinate collateral on the loans it purchases as a means of allowing private lenders to extend additional credit to individuals when warranted.

To further offset costs, we suggest that private lenders who sell non-performing loans be obligated to pay some portion of net income each year until the difference between the book value and recovery value of such loans is satisified.

As you know, it has been suggested that I utilize the revolving fund provided for in the Farm Credit Act of 1971, which permit the purchase of up to a total of $280 million ($150 million for BC and $130 million for PCA,FICB) in stock for the temporary assistance of certain Farm Credit System institutions. The fund is designed solely to provide temporary capital to meet the emergency credit needs of an institution; it is not designed nor is it capable of

meeting long term problems brought about by reduced earnings. The Farm Credit System presently has adequate reserves and retained earning to address the current problems it is faced with.

Use of the revolving fund would have the consequence of seriously jeopardizing the private status of Farm Credit System institutions and the independence of the Farm Credit Administration.

As another alternative, the Federal Farm Credit Board suggests that a far more effective use of the revolving fund may be to establish a Farm Credit System self-insurance program to finance the loss sharing agreements of the System in a manner not unlike the Federal Deposit Insurance Corporation. Consideration should be given to utilizing the revolving fund provided for in Section 4.1 of the Farm Credit Act of 1971, as amended, as the initial funding source, followed by Farm Credit System premiums.

IV. INITIATIVES TO STRENGTHEN THE FCS AND FCA

Now, as promised earlier, I would like to share with you some comments and suggestions based upon experiences of recent years. The results of these lessons may have great implications as you consider legislative measures to strengthen and improve the nation's agricultural credit delivery system.

The subcommittee also needs to consider several options for strengthening the Farm Credit System and ensure that it can respond to present day financial market realities. Consideration should be given to effort to facilitate the utilization of the Farm Credit System's asset base to respond quickly and effectively to the financial needs of member institutions.

As you know, the Farm Credit Act allows banks and associations under the same title of the law to merge, but does not contemplate mergers of unlike institutions. The financial stress being experienced by certain groups of system institutions requires that the combined strength of the system's capital base be available to assist threatened institutions. This need is being addressed by the system and the FCA in two important ways.

First, the systemwide financial package being put into place to assist the Spokane FICB clearly demonstrates the capacity and willingess of the system to recognize and act upon the need for self support mechanisms. The model established in Spokane may serve as a vehicle for bringing system resources to bear on future problems that may arise in other areas of the system.

Second, the system has within the authorities conferred in the 1971 Act the ability to access the combined capital base of banks and associations at the district level. The broad loss sharing and loan participation authorities which Congess granted in the Farm

Credit Act Amendments of 1980 allow unlike system banks or associations to enter into arrangements among themselves to share their capital support bases. They need only realize the common economic interest in each others survival and prosperity and the intention of Congress that service to system stockholder/borrowers across this nation be placed above the interests of individual institutions, and to take action.

The FCA believes that the boards and managments of system banks and associations now realize the need to utilize the system's capital base more efficiently. FCA believes that the system should address all avenues by which this objective may be achieved including legislation.

Great strides have been made in recent years to coordinate system management and delivery of services to farmers and ranchers. Presently, every Farm Credit District with the exception of Jackson has elected some form of joint management at the district level. This coordination has resulted in considerable efficiencies and economies in bank operations. The coordination effort has also been successful at the association level. The reality of one stop service to all system stockholder/borrowers is spreading at an encouraging rate.

Regarding FCA's own operations, I am convinced that the Farm Credit Act of 1971, as amended, does not equip it with tools

adequate to perform its duties as the examiner, supervisor and regulator of the cooperative Farm Credit system. The FCA has no formal "intermediate enforcement" authorities which woud permit it to stop or alter a course of action that is unsafe, unsound, threatens the strength and stability of a Farm Credit System institution, or violates laws, rules, or regulations.

The FCA needs the same types of intermediate enforcement powers tha are exercised by the Comptroller of the Currency, the National Credit Union Administration, the Federal Home Loan Bank Board, the Federal Reserve Board, and the Federal Deposit Insurance Corporation, in connection with the institutions under their jurisdiction.

With these authorities, FCA will be authorized to issue cease-and-desist orders to suspend and remove officials, and to assess civil money penalties as a means to deal with violations of the law or regulation and unsafe and unsound practices. In connection with such powers the FCA should also be granted "sue and be sued" authority, and the power to issue subpoenas and take other appropriate actions in connection with enforcement proceedings.

Mr. Chairman, I stand ready to assist you on these matters in any way you wish. Once again, thank you for inviting me to testify before you today.

Senator PRESSLER. Let me, first of all, thank our witnesses very much and say that I think the general feeling is that not enough is being done. The 8 points and 4 points outlined by the Department of Agriculture are not going to do the job. But you people carry out the policy. It is Congress' fault and OMB's fault if it is anybody's fault.

The point I am making is that—you can carry a message back to your superiors but the policies are made at the Secretary of Agriculture's level, OMB Director and in the Congress. It our responsibility also. If there is blame to go around, it can go in a lot of different directions and I don't want to put it on your shoulders here today. We just want to get the facts.

Now, Ms. Lawrence, you said that the principal write-down has not worked well. Why hasn't it?

Ms. LAWRENCE. Mr. Chairman, when a bank or a PCA writes down principal, it has to take the financial loss or the hit up front out of its capital assets. If that institution happens to be a commercial bank that is regulated by the FDIC, that is going to cause a problem with the regulator or, for that matter, with the Office of the Comptroller of the Currency.

It is going to cause a problem for that bank if it has to take principal hits on too many accounts because it digs into their loss reserves and that lowers the total number of loans they can make to other farmers in the community.

If they take the loss out of interest write-down, they have to take the same dollar value of loss, no matter which, whether it is interest or principal, but they spread the loss over the life of the loan, over 5 years and take it out of earnings instead of having to take the hit up front out of their capital assets. That is why we believe it will be more attractive to the lending institutions to do it that way.

And also, Mr. Chairman, there were not that many guarantees written with the principal write-downs, but the lending season is now. So the period between September and December, farmers were not applying for their loans for this spring. They are applying now. So it remains to be seen.

I talked to some bankers today from Nebraska who intend to continue to do principal write-downs, but it is a bank that is in very healthy condition and they can afford to do so, and they intend to continue to do the principal write-downs. Others may find it more advantageous to their boards of directors and their stockholders to take it out of earnings.

Senator PRESSLER. Well, let me say, Mr. Thacker, your agency has been forced to close down some banks or reorganize them. In my hometown of Humboldt, SD, the bank was closed, and that was not due to bad agricultural loans as far as I know or based on what I read in the paper anyway.

When you do have to go in on Friday night and put up the sign that the bank is being reorganized, and it will be reopened on Monday morning and deposits are safe what becomes of the agricultural loans there? I know there were many complaints in our community that the buyer of the bank took over the good loans or the best ones, so to speak, but the fellows who had any problem or remote problem were foreclosed on or their loans were not taken

over. What happens when some of these agricultural banks or small town banks go under? What happens to the farmers and ranchers who have loans?

Mr. THACKER. Well, Mr. Chairman, the policy that we attempt to pursue at FDIC is to work out a so-called purchase and assumption transaction, which means that we would package whatever assets we think a prudent buyer would be interested in buying and bid those along with all the liabilities of the institution off to potential buyers.

Unfortunately, no one is going to bid on loans that just caused a bank to fail. So in reality the only loans that we can pass immediately to another institution are the good loans. So that leaves the FDIC generally with two other classes of loans, and that is what I would refer to as a middle group which have some weaknesses that another lender would be reluctant to pick up at book value. But, on the other hand, they may well have borrowers who with additional funding and time would come out of the situation. Then you have got the bottom layer which virtually no one wants because they don't have a prayer of making it anyway.

We have a fiduciary responsibility in these situations because in fact we actually represent, we are a trustee, for the shareholders of the failed bank and any other creditors of the failed bank that are not insured. So we are under a statutory obligation to try to maximize our recovery on the assets which we retain.

For those that we identify as having at least hope, we attempt to work with those borrowers and attempt to get them refinancing, if it is at all possible, from another institution. As we have time, we package these loans and attempt to sell them to other institutions at discounts.

For those that have absolutely no hope, that we identify that we feel have no chance of coming out of it, we would have no recourse except to begin some sort of action to attempt to salvage whatever we could in our fiduciary responsibility.

The program that Ms. Lawrence mentioned a few moments ago will help us we believe in placing a good number of this middle category of borrower because what we will be able to do is offer these loans to another lender with Farmers Home guarantees, that is not the whole package, but another lender would take next year's operating loan with a guarantee from the Farmers Home and we would agree to hold all portions of the credit that we have to that borrower and not disturb the operation and not do any foreclosing and not demand any payments so long as the borrower is living up to all of the arrangements and commitments with Farmers Home, FDIC and the third party lender. That is basically how we attempt to deal with those.

Senator PRESSLER. Now following that up, Ms. Lawrence, as I understand, there is about $700 million in fiscal year 1985 available for the additional loan guarantee authority or the debt adjustment program. Now is that going to be enough and how would we increase that? Is there more money in the ag budget already appropriated or authorized, or would we have to pass an appropriation in the Senate and House to increase that?

Ms. LAWRENCE. Right now we think there is enough.

Senator PRESSLER. You think there is enough?

Ms. LAWRENCE. Yes. We are going to watch it carefully and see what there is. There is to a small degree some ability that the Secretary has to transfer funds from other accounts. We are just going to have to monitor it as it goes. But right now, Mr. Chairman, we believe that there is sufficient funds in that particular account.

Senator PRESSLER. I would predict that if the program is used to meet farm credit needs, it is going to run short fairly quickly.

Ms. LAWRENCE. We are going to watch it very carefully. But last September when the principal write-down was announced many of the people who supported principal write-down at the time cautioned us that the $650 million that was there was not enough and it is still sitting there. So we want to, before we ask for any additional funding, we want to be sure that we are going to use the funding we have.

Senator PRESSLER. But I hope we can tailor the program so it is used. I think part of the reason why it is sitting there is your earlier point that there is a reluctance to write down principal and I hope that we have it tailored so lenders will participate.

Mr. Wilkinson, you suggested a land acquisition program. Do you have any idea how much land would be acquired under such a program and how it would work?

Mr. WILKINSON. It is at this point, Mr. Chairman, a conceptual idea of a method by which we can stop the snowball from rolling any faster than it is right now. Land values must have some method of stabilization.

Senator PRESSLER. It is your viewpoint they will stop going down; is that true?

Mr. WILKINSON. At some point they have to begin leveling off at a point where they will be able to reflect true market value, but my fear, as I expressed earlier, is that they are going to go below that and they are going to cause undue damage which it wouldn't have been necessary.

Senator PRESSLER. I was talking with two other Senators on my way to this meeting. In their States it is hard to get a bid on land. So you really don't know the value of it.

Mr. WILKINSON. That is exactly right, sir.

Senator PRESSLER. Exactly how far down will it go? It appears farmland is about a third to a half of what it was a few years ago. I can't imagine it going lower, but it might. It is hard to determine the value of land frequently because you can't get a bid on it.

Mr. WILKINSON. It differs so greatly from one part of the country to the other. Last Friday in Cedar Rapids, IA, I asked that very question. Land that had been priced at $3,300 per acre during peak time could not even get a $1,300 bid at a sale just a few weeks ago, and it is continuing the downward spiral, sir.

Senator PRESSLER. I have a number of other questions, one of which any of you can take a crack at. As I understand it, the current prime lending rate is 10.5 percent, yet the average interest rate for superior customers in South Dakota is over 13.5 percent, and for those who are retail customers interest rates are much higher than that. What can be done to bring these rates closer? Maybe that is one for the FDIC.

Mr. THACKER. Mr. Chairman, I think the first thing would probably be to moderate loan losses.

Senator PRESSLER. To moderate?

Mr. THACKER. Loan losses.

Senator PRESSLER. Part of that interest rate is loan losses is your point?

Mr. THACKER. Well, you have got to get a higher enough spread to cover anticipated losses.

Mr. WILKINSON. May I respond to that, Senator Pressler?

Senator PRESSLER. Certainly.

Mr. WILKINSON. The cooperative credit institution has to operate within the revenue available, and it does go to the money market and it does pay what is necessary to secure its billions of dollars almost weekly. It then has to add to the top of that the markup for the banks themselves and then the production credit associations, and they are not luxuriously operated institutions.

But the basic difficulty is that they have been absorbing losses for 3 and 4 years, and what Mr. Thacker says is exactly right. They have to cover their reserve for losses and replace those reserves by the added interest rate. And, frankly, at this particular point in various parts of the United States because of those losses, the farmer's own cooperative credit system is no longer competitive with some of the commercial banks that are able to spread their burden to other types of the economy. Farm credit is limited specifically to agricultural production and cooperative loans.

Senator PRESSLER. This subcommittee will be making some legislative recommendations to the Finance Committee, the Agriculture Committee and other committees. We will also take ourselves as a result of these hearings and as a result of the second hearing that will be held in late February.

I would say that we are going to have to do much more. You have presented the facts as they are today in your fine statements and we look forward to working with you. The outlook is fairly grim for a farmer who is in trouble even with these programs that now exist.

I thank you very much, and in the interest of time I am going to call our next panel forward. Thank you.

Ms. LAWRENCE. Thank you, Senator.

Mr. WILKINSON. Thank you, sir.

Mr. THACKER. Thank you, Senator.

Senator PRESSLER. I now call forward Paul Nordstrom who is president of the Security State Bank in Geddes, SD, and I might have him speak first because he is a banker out on the firing line. I will also call John Haerter, the president of the South Dakota Bankers Association up.

The board of directors of the Farm Credit Council are not yet here. They are over testifying in the House I understand. So we will go a little out of order. I think Paul and John are two good representatives of our South Dakota bankers. I really appreciate you fellows coming in on such short notice. Just sit down and make yourselves comfortable.

I think we have got some of the wrong names down here because we had anticipated a panel. I really appreciate you two being here because you are both bankers in relatively small towns, relatively speaking. Although in South Dakota maybe you are from fairly big towns. My hometown has got 450 people, and that is pretty big.

But, Paul, maybe you could start out. By the way, I am sorry I couldn't join you fellows for lunch today or something. There are so many meetings going on when we are in session that we get spread kind of thin. I hope to see you both later.

STATEMENT OF PAUL NORDSTROM, PRESIDENT, SECURITY STATE BANK, GEDDES, SD

Mr. NORDSTROM. Thank you, Senator Pressler. My name is Paul Nordstrom. I am president of the Security State Bank in Geddes, SD.

Geddes is a small town of 300 people in the south central portion of the State. We probably have been a little more fortunate there than some of the other farmers and business people in the eastern part of the State. We have had a crop for 3 years in a row, and in our semiarid country that is a surprise. We have come through it real well for the past several years. Yet, we still have these credit problems. So we sometimes wonder what the solution is, and why the problems stay.

I didn't have time to present a written format. So I will have to just kind of go off the top.

You have to remember in banking and in a small community we have two different types of customers. We have our depositors and we have our borrowers. We have about two depositors for everyone who borrows. So when the rate was going up the last few years, the depositors were quite happy. I thought this was great, the greatest thing that had come along for them, 14, 15, and 16 percent CD's that they were living off. It was quite a boost to time.

Now our farm customer, he would come in and he was feeling quite bad. He was looking at interest of 16 plus, you know, and it was too much. Now that the CD rates are coming down, we have some sad depositors. They got accustomed to a little higher return on their savings, and this was the first time in their lifetime that they had higher returns. This is because banking became somewhat deregulated in the deposit-taking function and we have become more market orientated as far as handling our deposits and loans, the same thing that maybe the farm customer is going through now as agriculture becomes market orientated and it is subject to a lot of fluctuations.

In the past, rates would change maybe only every other year, and then only a quarter of a point. Then we went through a period where they were changing weekly. So this was some tremendous change they had to go through.

Now on the lending side, we have our borrowers who made some decisions back 5 or 10 years ago to expand their operation. It was based on 8 percent long-term money rates. All of a sudden that went up to maybe 13 or 14, but the return, a comparable return on that asset that they purchased, did not increase.

So we are going through this difficult adjustment time where we have got to value return on assets based on a higher rate than we ever have before. Some of our programs in the past probably didn't work right. We subsidized land values by having maybe 5 percent interest rates to certain borrowers that drove up the price of land beyond what it should have been.

Now we have got to go through the adjustment time and get back down to what that land is worth in relation to what it produces. Yet we find the gross income off the land not much more than it was 10 years ago when we were at 8 percent interest or somewhere near that. It just hasn't made that adjustment.

This last month we had one piece of farmland come up for sale. This was an estate, so we had a fair market looking at it. It sold here at 3¼. Sometime back before, land in that area was probably 5 to 6 when the buyer was a Farmers Home buyer with 5 percent money. The other people had already bowed out of it. Those that had to go to the open market had already bowed out of that land sale. But the guy coming back now is the guy who had a little money in the CD pouch. He is gradually stepping over and saying hey, I maybe can do it at that level. They are taking a look at it. So maybe we have hit a bottom, I don't know, or maybe we hit some sort of adjustment.

But you have to remember and temper that with the fact that we have had 3 years of an above normal crop in the community that I am involved in. That is different than it is in the eastern part of the State where they missed two crops in a row, and they were not used to that. So there is some difference there.

The other thing that I see happening is that farming has switched. It used to be labor intense and the labor was provided by the operator and capital was not a major factor as much as it is now. Now to switch from different labor saving devices you buy heavier equipment and that requires different forms of energy that also have gone up. It has just come back to that operator in a completely different format.

I guess we all know that the lifestyle out there for our farm operator is completely diffferent than it was 30 years ago when I was out there trying to see what happened before I got invited into military service and I left South Dakota for a while. It has changed. The whole thing has changed. We have got electricity, got water out there and got some of the modern facilities that they never had before. This is a cost that comes back to the farm and the farmer and the housewife out there. They now require a higher standard of living than there were before. So there has been a lot of change going on and it has been gradual. It is real hard to sit down and know what the problem is.

I do know this, that it is difficult for a bank to turn around and lend somebody money for a longer period of time when I know that those customers coming in leaving deposite here are probably only leaving them for 6 months to a year at a time.

Sure, a majority of them will renew and stay with us, but it is market orientated. It is very volatile money that we are looking at out there. This was not a factor in the trends of the sixties and the seventies. The prime rate used to go up then and it never hit the farm and we still were lending at 8 percent all the time straight across as the fixed rate basically because the depositors were basically substituting some of the farmers' costs because they were not getting a market for their savings.

They were limited to a lower rate, and indirectly grandma and grandpa were subsidizing the rest of the farm operations. That has changed now in the last 5 years, plus the farmers are changing as

to how they derive their income. So you have these environmental changes both in the bank and in the farm, and it kind of came at us both at the same time. I don't know if I can add much more to that.

Senator PRESSLER. That is very useful. Of course, you are in area of the State where you said that you have been blessed by unexpected good crops. How many of your agricultural loans are in trouble or would be classified as such? Of course, as you say, if the story got around that your bank was in trouble, some of your depositors might decide to put their 6-month CD's in some other bank and you could be trouble fairly quickly I suppose. But currently what percentage of your bank, or not necessarily your bank, but what would you estimate banks of your size, what portion of the loans are close to being in bad trouble?

Mr. NORDSTROM. Well, this varies according to your policy in the past. If you were a very aggressive lender in the past, you acquired a lot borrowers with high debts. Then you would have a little higher ratio.

Two or three years ago I was indirectly blessed. They set up a new production credit association office not too far from there and some didn't like the rates I was charging. So they want over there. That makes us a very sound bank or tough.

Senator PRESSLER. So that in many cases they went to the government or perhaps the Production Credit Association.

Mr. NORDSTROM. Well, I wouldn't say tough, but I sleep easier.

Senator PRESSLER. Yes; now some people have said to me, and David Stockman said the other day that some of the farmers went out and borrowed a lot of money and as consenting adults they expected to make money and they apparently haven't. Now they are in a situation where from his point of view taxpayers are being asked to help out.

On the other hand, I suppose you could say that bankers or lending institutions were aggressive about getting the money out. I think from 1976 to 1981, probably not your bank because you have been cautious, but there are a lot of bankers who were very aggressive at loaning money.

Mr. NORDSTROM. No one is innocent. No one party is completely innocent. We all were involved in it and we are all basing it on different envirnonmental situations, and the inflation factor really covered a lot of mistakes and we allowed it to happen. No matter what we do, we look at the borrower's operation and we would see that the assets that we has to lend against would increase in value.

So we just relaxed and did not take a close look at that. If we could have stripped inflation off of there, we probably would have realized years back that there was an adverse trend, but it was convenient not to. And we all went that route. Every lending agency did the same, and some of the borrowers were drawn into that which became a trap. We also were drawn into it.

Senator PRESSLER. Now how much does land sell for by the acre in your community?

Mr. NORDSTROM. Oh, at $3¼, you will get a buy.

Senator PRESSLER. $325 per acre?

Mr. NORDSTROM. Yes.

Senator PRESSLER. How much was it 5 years ago?

Mr. NORDSTROM. Oh, 5 or 6, in that area is where it peaked out.
Senator PRESSLER. So about a 40-percent decline.
Mr. NORDSTROM. Yes.
Senator PRESSLER. A lot of agricultural loans were made based on land prices, is that right?
Mr. NORDSTROM. Right. But you must remember the land was based on an interest value of maybe 5 percent at that time and now we looking at a higher factor and there is some of your difference. You have got your return on investment and you crank in your expected yield and you will get pretty close to the capitalized value.
Senator PRESSLER. Is that a contract for deed?
Mr. NORDSTROM. No, this one is a sale. The last one is an actual cash sale.
Senator PRESSLER. They used to have a lot of contract for deeds at a fairly low interest rate, and I guess the IRS has ended that.
Mr. NORDSTROM. Well, they have put an imputed interest factor in there that is going to slow that down. Especially it is going to hurt, I think, interfamily transfers. There will be some problem there. That is a difficult thing, too, because a lot of ranchers and farmers got in trouble a few years back, especially some of those who are probably 45 to 55 years old now who 10 years ago decided hey, I want to bring my son in on my operation. And all of a sudden they doubled the size of their farm operation and took on a lot of capital investment on borrowed money.
It did not work because at the time they did it the prices changed. They got caught at high time. They just make the transaction or the shift at the wrong time. They expanded at the wrong time for them and they were trying to do what they thought looked good to bring their family back into the farm operation. It doubled, it hurt and it went against them.
Senator PRESSLER. Paul, I am going to ask you some more questions later, but now we want to hear from John Haerter, the president of the South Dakota Bankers Association. Later we are going to hear from the National Independent Bankers Association who have presented a credit plan that was written up in the Wall Street Journal.
In any event, first of all, John we are glad that you are here and we want to hear from you. I believe your association is having its convention in Washington.

STATEMENT OF JOHN HAERTER, PRESIDENT, FARMERS STATE BANK AT HOSMER, SD, AND PRESIDENT, SOUTH DAKOTA BANKERS ASSOCIATION

Mr. HAERTER. Not really. But, first of all, Senator, I would like to say that I am also from a large city in South Dakota with a population of 450 people.
Senator PRESSLER. All right. That is a pretty good size town.
Mr. HAERTER. That is a pretty good size town.
Senator PRESSLER. It is bigger than Humboldt by 20. [Laughter.]
Mr. HAERTER. We might have lost a couple.
Senator PRESSLER. OK.

Mr. HAERTER. My name is John Haerter, and I am president of the Farmers State Bank at Hosmer, SD, and I am also president of the South Dakota Bankers Association.

Really the meeting that is going on here today is an ABA leadership training session conference and not a South Dakota bankers association.

Senator PRESSLER. OK. Well, there are several South Dakota bankers here.

Mr. HAERTER. Yes, there are some here. As a matter of fact, I think there are three of us here.

Senator PRESSLER. That is a pretty big group.

Mr. HAERTER. There should have been six. [Laughter.]

Senator PRESSLER. A crowd.

Mr. HAERTER. I guess to kind of keep this all in some kind of focus here, I am located in the north central part of South Dakota and my bank would be one of the smaller banks in South Dakota and it is under $10 million. That is the strange thing about South Dakota. We have very small banks and we also have Citicorp. [Laughter.]

This area would consist mainly of family farms, small businesses, including the rural community banks. My bank and I would also imagine most other banks in our area are probably 80 percent agro lending banks. I guess this makes it very easy to see that if agriculture does well, we all do well. But it is also very scary because a part of this scenario is that when farmers fail so do many of the businesses and the banks in the area.

I guess talking about scary things, and I know you have talked about this, I have heard you talk about it in the last hour or so, but, anyhow, in a recent farm journal magazine I just read that 42 percent of the farmers of our area, and that would include not only South Dakota, but North Dakota, Minnesota, Iowa, and Nebraska, 42 percent of the farmers are in troubled financial shape, and that half of these could go out of business in 1 year. Now I don't think that really would pertain probably to my area, but statewide it could.

The survey also indicated that South Dakota farmers have the highest debt to asset ratio in the Nation. I am not quite sure about either, but that is what it said.

This prospect of having to accommodate these troubled loans over the next few years is cause for concern for all institutions. And I think, Senator Pressler, what we were relating to earlier about why the interest rates have not dropped, I think that is the problem.

I think we are all anticipating more and more foreclosures and people quitting and banks taking some large hits. And I think in anticipation of this, we are probably keeping our interest rates a little bit higher than we should. I think if we were somehow assured that this wouldn't happen, you would see a better prime rate in the agricultural area also. Of course, this cannot be guaranteed by anybody.

The net charge offs and loan losses among commercial banks have more than doubled since the 1980's and more than quadrupled in the agricultural banks.

The bank that I am in is a kind of a family bank and it goes back a long way. I don't think when my father ran that bank he probably had very many losses at all, at least not that I am aware of. I would hate to have him see what is probably going to happen with his son's bank.

Then again, like Paul said, despite a very excellent crop in our areas—now we are located in the northern part of South Dakota, which is not usually as great an area as the southern part—but in the last 2 years we have had an excellent crop up there back to back. And even the good managers of our farms could not make any debt reductions.

Now just think what would have happened if we had had average crops. I just hate to think about it. And, of course, the farmers that are having the most difficulty are the young, highly motivated and very efficient people, and the problem there is they know what they are doing, but they have absolutely no savings backing them up.

Now the older farmers that have been farming for some time, sure, they have some backing, but these young guys, and like Paul mentioned, that maybe in the seventies expanded, have nothing backing them up and this is just going to take them down the tubes if it continues.

And of course, the other thing is if this group is forced out of agriculture, they will never return, even if the economy should turn around. Likewise, the businesses in the small towns, implement dealers, automobile dealers, if they are shut down, they will never open again. And that is easy to understand. These implement dealers, the car dealers, when these small towns give them up, they are never going to go put their franchises back in there again, and the farmers haven't got the capital to recrank the operation.

Just kind of listening back here in the last hour, I think one thing that the FmHA could really do to help lenders is to give us interest discounts and maybe thereby we could enable some rescheduling of debts. And also, I would like to really see them go on this 90 percent guarantee of full principal concept again. I think this would at least help the short-term, the 60-day situations.

And of course, we don't only need short term, but we need long haul, and the long haul hinges on export markets, along with our Federal farm price supports. Now, obviously, we don't have anything to do with that, but it seems to me that the Reagan administration wants to reduce commodity price supports. I am not really saying I am for them, but I think they are about the right levels that they should be at right now.

With the export market so important, price supports have to be tailored to that reality. The strong dollar and the resulting foreign exchange rates are creating export problems for our farmers. And of course this has to be overcome so we can get rid of these large budget deficits and therefore hopefully we can get these interest rates down to 8 or 9 percent.

Now I know when we take our little minicomputer and we punch in a bunch of figures or numbers, it seems like we can cash flow a lot of guys if they are talking to this 7- or 8- or 9-percent interest rates. But if we are talking 13 and 13.5 and 14 and there up, there is just no way it will cash flow.

I guess I really up until this time have talked about my bank and not the South Dakota bankers, and I am not really sure of what topic I was supposed to be talking about today. But I have had this little thing of my little bank on my chest and I think I got it off of my chest anyhow.

But as far as the South Dakota bankers are concerned, we are making every effort to help this farm stress, and I don't really know what we can do at the moment other than probably have meetings throughout the State. As a matter of fact, we are having one Friday at Mitchell, and we are going to be working with the farm credit people of Omaha, the PCA's the Federal land banks and I think aid bankers. I don't know if we come up with anything that is really satisfactory or not, but I guess as far as an association is concerned, these are some of the things that we are trying to do, Senator.

Senator PRESSLER. Of course both of you are very well established and, obviously, people whose judgment is very experienced. So your banks are probably individually in better shape then some.

Mr. HAERTER. They probably are.

Senator PRESSLER. If the agricultural crisis continues will we see some banks, some smalltown banks going down? What will happen?

Mr. HAERTER. Well, I think, and this is what I mentioned earlier, you know, like I say now, we have had an exceptionally good 2 years back to back, and that is very unusual.

Senator PRESSLER. That is crop years?

Mr. HAERTER. That is the crop years.

Senator PRESSLER. Yes, that is very unusual.

Mr. HAERTER. That is very unusual for the northern part of the State. Now supposing we get a below average crop for the next year or two, then we are going to see a lot a lot of losses. And even my bank and some of the more conservative banks will be in big trouble. Even though we may be class one banks now, I'll tell you, we are going to drop that rating fast because these guys can't stand it. I mean they have been hanging on and hanging on.

In my particular case, and I am not too sure about Paul's, but in my particular case we still have a lot of older farmers out there and, you know, I guess that is good that we do have them. But how long can they hang on.

The biggest problem of it all is the young guys that are there. They are certainly going to go down the tube. There is no way other than that.

So, like I said, it may look good today, and we were audited by the FDIC in our bank in October/November and didn't have any big problems. But, like I say, just let 1 or 2 years come back to back the other way, you are going to see a lot of banks in big, big trouble.

Senator PRESSLER. Now you heard the testimony on the eight points the Secretary of Agriculture has announced.

Mr. HAERTER. Yes.

Senator PRESSLER. How helpful will these actions be in South Dakota?

Mr. HAERTER. Well, I really don't know either. You know, that first program didn't do a thing. I don't know of any bank in my area that had even thought about using it.

Senator PRESSLER. Very few banks have used it. They have had the program in effect since September and only $50 million has been used out of $700 million, which indicates to me that very few banks would consider using it.

In other words, you think that from the point of view of most small rural banks the present proposed so-called new initiatives really don't meet the need?

Mr. HAERTER. No, not at all. As a matter of fact, I think you kind of related to it a little bit. If that would have been a good thing, that $700 million would have been not even enough, and look what happened.

Senator PRESSLER. Yes.

Mr. HAERTER. I mean that is peanuts really and it didn't even go out.

Senator PRESSLER. Yes. I think that is right. I think that is a point we have to make. We in the Senate have to take responsibility for initiating a much broader program because obviously the Department of Agriculture, although there is discretionary authority to go much further, apparently are choosing not to do so. That program, in my view, doesn't reach the problem as I see it.

Mr. HAERTER. No.

Senator PRESSLER. I thought maybe it would in some States, but after the testimony today I doubt that.

Mr. HAERTER. Not at all, Senator. That didn't do a thing.

Senator PRESSLER. OK.

Mr. NORDSTROM. No, it isn't going to help or do that much for us because we are looking at a situation where farm assets probably at their best will return 5 percent. With interest charges out there of around 13, automatically anybody that is over a 30-percent loaned out is at the break-even point on operational cash-flow. And they are the wealthy farmers that will hit that point.

What about the man who basically is 80, 90, or 100 percent in debt? It would take a big grant to bail him out. I mean, it is a problem. We would like to be able to keep them there, but this is where management in looking at what they are doing is more important.

If we could somehow get them realizing that they have got to do things more efficiently, but every time they do it more efficiently, you add more to the total production and that becomes a little bit self-defeating.

Senator PRESSLER. Are the farmers coming into your banks now for their spring loans? What is you big peak time? Is it February and March before the spring planting?

Mr. HAERTER. I would say ours will start shortly.

Senator PRESSLER. It will start shortly?

Mr. HAERTER. Yes. I would say within 3 weeks.

Senator PRESSLER. Now will some of these so-called changes by the FDIC in cash-flow requirements and so forth, allow you to change your policy, or are you going to continue your current policy?

Mr. HAERTER. Well, I guess I must say one thing. Like I mentioned, we were audited by the FDIC in October/November, and at

least the people I had at my bank were very understanding. As a matter of fact, I guess I was bracing for the worst and hoping that I could somehow survive it, but really they were pretty nice people. They seemed to understand the problem.

Now I have talked to some other ones and I didn't have quite that luck, I guess, but these examiners we had didn't really ask us to change anything. I mean, as a matter of fact, they were understanding. They said we know you are having more delinquent loans than you had in the past, and we know this and we know that, but we understand.

So I guess as far as my shop is concerned, we are not going to really make many changes.

Senator PRESSLER. I am going to bring Tom Olson of the Independent Bankers Association of America to the table if he is here.

Is Tom here or his substitute?

I guess he is still over in the House testifying.

Well then we will continue here for a time.

Mr. HAERTER. I guess, Senator, one other thing I would like to mention, and I just happened to think about it and it is very real up in our area. If things continue for a couple more years, we are going to run out of people.

Senator PRESSLER. You are going to run out of people?

Mr. HAERTER. We are going to run out of people. I mean the younger guys are going to leave. The older guys say well, we are going to take what we get before we lose it all. There isn't going to be anybody left out there.

Senator PRESSLER. Well, what is going to happen?

Mr. HAERTER. I don't know.

Senator PRESSLER. Who is going to farm the land?

Mr. HAERTER. Well, there we go to land values and what are they going to do? I mean this is what is happening. We are losing the people in the small towns and we are losing the people out on the farms. Like I say, they are not coming back. Whenever they are gone, they are going to be gone. They are going to either go to Sioux Falls or maybe to New York. I have no idea where they are going to go, but they are going to leave and we are going to run out of people.

Senator PRESSLER. They might be unemployed in some city collecting unemployment.

Mr. HAERTER. Well, sure. That is what I am saying. If we want more people in the cities, that is where they are going to go.

Senator PRESSLER. Now these loans coming up for the spring planting, are there a lot of guys in your communities that you are going to have to say no to as a result of increased problems?

Mr. HAERTER. Well, you know, I guess I hate to make a broad statement there, but I think——

Senator PRESSLER. Not your bank so much, but agricultural banks in general?

Mr. HAERTER. Well, it will be, you know—Larry, it is going to be a 1-on-1 thing. I mean you are going to have to sit down there and these cash flows have to work somehow. Maybe the guy's honesty from the past, there are going to be a lot of things that are going to go into this little thing and I think we are all going to try to make

them. Just like I say, I don't run out of people out there. I don't want to be the only guy left up in North and South Dakota.

Senator PRESSLER. I know. Many businessmen and bankers have told me that they want this agricultural thing to be solved because they absolutely depend on keeping the farmers on the land.

Mr. HAERTER. Absolutely. Absolutely. That is the whole key. If they are gone, we are done. Absolutely.

Senator PRESSLER. I think there is a real interdependance or a real close relationship, so to speak.

Mr. HAERTER. Oh, it is as close as you can get. It can't get any closer.

Senator PRESSLER. But if you do have a farmer or a rancher who you have loaned money to but you can just see that he is slipping, do you urge him to sell out or do you keep him going another year?

Mr. HAERTER. Well, that is why I say that is a 1-on-1 situation. And I guess if I had a farmer like that that was in that particular spot, you know, I guess he will just have to go.

Senator PRESSLER. We are going to hear in a minute from some of the other farm credit people. But maybe they have taken more of the worst cases, so to speak. Would that be an accurate statement of PCA's and FmHA?

Mr. HAERTER. Yes.

Senator PRESSLER. Obviously that is what they are designed to do in part. So they probably have more bad debts.

Mr. HAERTER. Yes. I think probably Paul hit on a point here earlier that might be of some relationship here a little bit. You know these small community banks, we all know each other really well. I mean we are all friends. I know every person in the area and everybody knows me. So when you work with a group like that, you know a little bit more the lender or the borrower, or vice versa, than the PCA's or the Federal land bank people that are sitting in the larger towns in South Dakota and are constantly moving.

I mean I don't think they have got a loan officer there more than 3 months. Nobody ever knows anybody. So I think those are the people that might get into a quicker jam and take a bigger hit than a situation like Paul and I might have.

Senator PRESSLER. You might end up being in a very painful position. Everybody always thought that it is a great privilege to be a banker, and it is, and to be president of a bank. But if this thing gets worse, you will be on the cutting edge of giving the bad news.

Mr. HAERTER. You bet.

Mr. NORDSTROM. We already have.

Mr. HAERTER. Like I say, we already have. So have I.

Senator PRESSLER. Of course, I think everybody appreciates that you are caught in between. You are not the giant banks that determine things but you are the guy who has to say no or has to tell somebody they have to sell out. I know in the movie about the Iowa family that had to sell out it was the banker that got criticized the most, but he was merely doing what he had to do. The local banker had the great crisis of conscience because he didn't know quite what to do.

Please stay here at the table. I am told that John Harling of the Omaha Farm Credit Bank is here and Delmer Banner, president of the Farm Credit Council, Washington, DC, and Ray Moss Tucker.

Could we all just spread out there a little bit and get you all at the table. I think having these two practicing bankers here is a very great asset to blend in.

I apologize if I have kept any of you waiting. Somebody said you were over in the House testifying. So maybe you have been testifying all day and you are probably exhausted.

John, why don't we hear from you first.

STATEMENT OF JOHN HARLING, CHIEF EXECUTIVE, FARM CREDIT BANKS OF OMAHA, ACCOMPANIED BY DEL BANNER, PRESIDENT, FARM CREDIT COUNCIL; AND RAY MOSS TUCKER, CHAIRMAN, BOARD OF DIRECTORS, FARM CREDIT COUNCIL

Mr. HARLING. Thank you, Senator.

We have been over at the House all day and appreciate this opportunity to visit with you.

I am John Harling. I am the chief executive officer and president of the Farm Credit Banks of Omaha. I am here as a representative of the Farm Credit Council Legislative Committee and will be in that capacity as I visit with you this afternoon. We have heard all day about the deteriorating conditions in agriculture and in agricultural credit, and I presume that that same conversation has been going on here.

Probably nowhere else in this country has the distress been more painfully evident than in Midwestern States of Iowa, Nebraska, South Dakota, and Wyoming, which happen to be the same States that are served by the farm credit banks of Omaha.

What we are looking at is a double-barreled impact of declining asset values coupled with the lower net farm income performance, and that has had a dramatic impact on the farmer's balance sheet.

In recognizing this some months ago, the Farm Credit Council organized a task force to look at short-term credit alternatives, and later on we teamed that task force up with a similar kind of group that was working out of Iowa State University. There studies have indicated that 8 to 10 percent of the farmers nationwide have debt asset ratios in excess of 70 percent, and in fact will be insolvent within 2 years.

It is further distressing to note that this group owes between 25 and 30 percent of all outstanding farm debt, but owns only 8 percent of the farm assets. The same Iowa State University economist went on to state that for this group annual interest cost is about double net income and liquidations seem inevitable.

When applied to the total agricultural debt, those percentages suggest that there could be as much as $66.3 billion of farm debt that falls into that category. Again, using the assumption that those producers who have debt asset ratios in excess of 70 percent really have no alternative but liquidation, then the magnitude of the problem is very great.

So when you look at it from a public policy standpoint, the question is how fast can we allow this transition to occur without destroying the rural community.

We believe that more than just the farmer is being impacted. Others feeling that threat of rapid deterioration include the rural banks, farm credit associations, the farm suppliers, the agri busi-

nessman who is supplying the producer, including the cooperatives that he owns, the small town retailers and other rural entities.

We in farm credit are vitally concerned about the impact of this stress and have taken a number of actions internally that will enable us to continue to assist our borrowers in coping with it. But these actions, while they may be enough for farm credit to deal with the present level of stress, they won't be enough for the industry in total and they won't be enough for farm credit if the deterioration continues.

The problem that simply must be addressed today is the lack of income and the lack of any prospect of income for tomorrow. We are not going to solve agriculture's problems simply by extending more cheap credit. But if corn prices go to $4 and soybean prices go to $8, that is certainly going to go a long way toward helping.

Last November the Farm Credit Council submitted a number of recommendations to improve the debt adjustment program. We were among the many who called for interest write-downs in lieu of the otherwise required principal writeoff to bring those loans into performing condition.

We are pleased to note that the administration's willingness to permit those interest rate write-downs now has been extended and, yet, when we poll our farm credit banks around the country, they indicate that there is no participation to date and, frankly, we don't expect any significant level of participation under that program.

And while a few can and will participate, those associations whose borrowers need this kind of relief the most cannot afford to take the level of writeoff that is needed to bring those loans into a performing condition. In most instances they are already carrying nonincome producing assets at a level which makes their interest rate noncompetitive.

We don't think that any one program can be a solution to the immediate, let alone the long-term problem. Therefore, we support a variety of measures that would be put into place immediately that could increase the level of available credit for the 1985 operating purposes.

The first of those are those revisions to the DAP program along the lines that were recommended by the Council in that letter dated November 19, and that has been attached to our testimony. In addition to that, a Government funded interest subsidy that will bring the loan to a performing condition.

Second, providing guarantee authority of up to $3 billion to be used, not only for DAP, but for the more traditional Farmers Home guarantee programs.

The third suggestion is to target Farmers Home resources and increased personnel levels into those high distressed areas.

Fourth, to eliminate guarantee fees that must be borne by farmers who are already strapped for cash.

The next is to alter the Farmers Home takeout procedures to conform with those in place under the SBA guarantee programs.

And, last, to permit the Government to advance to farmers this spring a percentage of the commodity loans that they will be entitled to this fall with the requirement that the borrowers meet a

denied credit elsewhere test first and, in addition to that, that they participate in the crop insurance program.

Mr. Chairman, we suggest that these alternatives for implementation be put into place immediately. That would help slow the deterioration of many borrowers.

A workable guarantee program would provide an additional measure of security to lenders while helping borrowers in this group to meet their debt service requirements.

But in addition to high interest rates, the borrowing capacity of all of agriculture continues to erode due to the continuing downward spiral of farm asset values. The prospect of significant numbers of farm liquidations and the lack of confidence in the country has gutted the real estate market.

Not only has the drop in farmland values wiped out the equities and borrowing power of many producers, but the cost of carrying that acquired property that cannot be moved onto the market is forcing loan interest rates upward and thus further aggravating the problem for all borrowers.

To restore order to the market for farm assets and to stabilize those land and machinery values, we would support immediate formation of a limited life, limited purpose corporation under Federal law. It would be a mixed ownership corporation. It would be federally chartered as the Agricultural Conservation Corporation or ACC. It would be empowered to purchase the farm assets of distressed farmers and their lenders, including the Farmers Home Administration.

It would lend much needed stability by holding and disposing of these properties under local direction and in an orderly manner over a specified period of time.

Who stands to benefit from this concept? More than anybody else, the farmers themselves would benefit from a return to liquidity in that land market. Land is the principal base of wealth in the farming sector. According to the same Iowa State economist, the land in that State and in neighboring States has already fallen to or is very economic levels under current income prospects in agriculture and, yet, those land values continue to fall.

In much of the Midwest if a farmer wants to sell a portion of his land to help reduce his indebtedness and restructure his loan he can't find a buyer for that land. Stopping this downward spiral alone would prevent farmers who have thought they had a secure equity position from quickly sliding into an unsecured position.

The ACC would facilitate the voluntary transfer of excess real estate, and as a result of the ACC taking over the carrying costs of those nonperforming assets, lenders will no longer have to pass these costs on to borrowers through higher rates.

Farmers would also benefit by virtue of the fact that many are themselves contract sellers. Perhaps most importantly by holding land out of production the ACC could significantly contribute to much needed land reserve and thus reducing production and enhancing the profit outlook for all of agriculture.

I would like to touch on just a few of the essential features of the Agricultural Conservation Corporation as we envision it.

The Corporation would be capitalized primarily by its users, that is those lending institutions and individuals who transfer property

to the Corporation. In exchange for the transfer of land and machinery to the ACC, they would receive only a portion of the value in cash. The remainder they would receive in stock. Additional capital might possibly come from State governments as well as from individual investors.

The Corporation would have the authority to issue Government-guaranteed debt instruments to fund it. The Corporation would be authorized to acquire farm assets, including real estate machinery and equipment at fair market value. Property so acquired would be held off the market and managed perhaps out of production and disposed of under the direction of local committees.

It could be operated through farm credit associations or other local lending institutions whose services would be provided on a contract basis.

It has the potential initially to return a substantial amount of capital to the U.S. Treasury and, in addition, provide annual savings through reduced interest costs.

Mr. Chairman, we believe that this measure of intervention is urgently needed to restore order and reason to the market for farm assets. We believe this option should be vigorously pursued.

Our task force is eager to work with the members of this subcommittee and their staff in order that legislation might be offered to establish this entity at the earliest possible time.

We in farm credit are vitally concerned about the current level of stress in agriculture. There is a feeling of despair that is filling the farm homes, the smalltown businesses and loan offices. There is a crying need for a signal from Government that would restore some confidence to the farming sector. This we can do for a time through interventions such as those we have suggested, but these alternatives, like forbearance, can be rationalized only in the light of a prospect for restored profitability in agriculture.

Mr. Chairman, we pledge our assistance in working to urgently and productively respond to the issues that are being considered by this subcommittee.

I appreciate very much the opportunity to appear on this panel with Mr. Tucker and Mr. Banner today on behalf of the farmer-owned institutions of the farm credit system that hold a third of the Nation's farm debt.

I would be glad to answer any questions that you might have.

[The prepared statements of Mr. Harling and Mr. Tucker follow:]

THE FARM CREDIT COUNCIL
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Statements of

Ray Moss Tucker

and

John Harling

on Behalf of

The Farm Credit Council

Before the

Senate Small Business Subcommittee

on

Family Farm

February 7, 1985

Mr. Chairman. I am Ray Moss Tucker, from Finchville, Kentucky. I am Chairman of the Board of Directors of The Farm Credit Council. With me at the table is Mr. Del Banner, President of The Farm Credit Council, and Mr. John Harling, Chief Executive of the Farm Credit Banks of Omaha and also a member of the Council's Legislative Committee.

I am pleased to be here today to speak on behalf of The Farm Credit Council. Formed late in 1982, The Council is the federated national association of borrower-owned farm lending institutions across the country. Its federated membership includes all thirty-seven of the nation's Farm Credit Banks, some 93 percent of the production credit and federal land bank associations along with a number of other borrower-owned farm lenders nationwide.

Collectively these institutions have presently more than $80 billion in loans outstanding to over a million of our nation's farmers and their cooperatives. That is a third of the nation's farm debt.

Mr. Chairman, As you know I am a farmer. I have a son and a daughter, in this 600 acre crop and dairy operation. My daughter and my son-in-law also have a beginning operation of their own. I know of the struggles in agriculture today.

I am also a director of the Farm Credit Banks of Louisville. They along with the other institutions for which I speak today are 100% borrower-owned and directed. There are no equity investors other than the borrowers

themselves. They exist for no other reason that I can think of, except to give credit-worthy farmers and their cooperatives a pipeline for capital from Wall Street.

Mr. Chairman, from the perspective of a director and a farmer-user of these institutions, let me be clearly understood: there is no farm **credit** crisis; but there is a farm **income** crisis that has afflicted many areas of the country now for as many as five years. As the result, little or no net farm income and dramatic reductions in farm asset values have left farmers in many areas of the country with a sharply reduced and, in many instances no, basis for financing.

The resulting stress is severely impacting every highly leveraged farmer and every institution that has invested heavily in agriculture. That includes not just farmers but country banks and farm credit associations. I need not remind this subcommittee that these Farm Credit Banks and Associations are single industry lenders: 100% of their loan assets are in agriculture.

I note that some are uncertain why the government should come to the rescue of farmers in these times--farmers who made adult decisions to go further into debt in the late 1970s. Well, they didn't count on a grain embargo; they didn't count on the value of the dollar reaching record levels and taking us completely from the foreign markets; they didn't count on record interest rate levels and low commodity prices; and they didn't count on successive drought years followed by flooding during the planting season. And yes, neither did their lenders or the Congress, or the extension service or the farm press count on these occurences.

But now it's 1985, and every study we've seen says that at least 30 percent of the farm debt is in the hands of borrowers who are at least 70% leveraged in their business. So far as we can tell, this is the volume of farm debt that will almost certainly be liquidated in the next two to four years.

In addition to these highly leveraged farmers, also threatened by the current stress is the infrastructure of Middle America -- the local feed stores, the cooperatives, the country banks, the implement dealers, the PCAs, and hardware stores and every community that depends on a prosperous agriculture.

As those institutions are impacted, . . . as they suffer the costs of losses on receivables . . . the higher costs are spread among the rest of the farmers--those who weren't highly leveraged. And it is they who will pay the added costs until they too are unable to service their debt or they take their business elsewhere--to regional suppliers and big city banks that have a base outside of agriculture that can afford to pick up the tab.

Anticipating these events, the board of directors of The Farm Credit Council initiated a Special Task Force on Credit Alternatives. A critical part of that Task Force effort was to develop the policy base for Farm Credit in dealing aggressively with the issues facing the Subcommittee today.

That policy base is in the form of a resolution adopted by the delegates to the Council's 1985 Annual Meeting held in San Antonio last month. A copy of that resolution is attached to this statement.

Through our Project 1995, we in Farm Credit are just completing a major look into the future of agriculture -- its capital and financial service needs over the next ten years. We cannot ignore that there is a major transition occurring in U.S. agriculture, its structure, production capacity and its markets. But as it continues, it is imperative that it be evolutionary and not revolutionary.

We therefore believe that short-term alternatives to normal operations must be found that will enable this transition to occur in a manner that is orderly, that is compassionate toward borrowers while also preserving of the institutions on which rural America must depend in the future.

That means that all of us in agriculture must have time. For those whose farm businesses can be saved, there must be time to adjust. For those whose businesses cannot be saved, there must be time for orderly and compassionate exit from this industry. For the lending institutions, there must be time to work with both these groups to assist them in making a successful adjustment. For the rest of agriculture, time is needed to bring order to the market for farm assets. This must occur if we are to stem the devastating downward spiral of land and farm asset values that is increasing the cost of credit while eroding the asset base and hence the borrowing power of all of agriculture.

The current problems in agriculture have been prompted by international and macro-economic--and I might add monetary--policies of government in recent years. Therefore government, we believe, should participate substantially in the short-term programs necessary to provide that much needed time. We therefore will support legislative alternatives which will:

1. Stabilize farm asset values, and

2. Permit the government

   a. to assume a greater share of the risk of farm financing, while

   b. providing the support necessary for lenders and those borrowers who have a reasonable chance of recovery to adjust during this time of transition.

I've spoken about time and about transition. I say transition because there are a large number of producers who hold a significant portion of the farm debt for whom there appears to be no saving short of a federal grant. For those leveraged over 70%, the interest bill alone is twice their net income. No amount of restructuring, interest write downs or forbearance can save very many, if any, of this group.

Mr. Chairman, I know that no one believes that forbearance comes soon enough for them or lasts long enough. But I also know the cost of time where money is concerned, and I know the cost of forbearance. As a bank director and as a farmer I have watched as these Farm Credit banks have carried out a specific policy of forbearance in the past 3-5 years. Before that we were rolling over debt, waiting and hoping for restored profitability.

While we have been forbearing and waiting, I have seen farmers lose the equity they had in their business--equity they could have salvaged had they liquidated three or five years ago. But the equity is now eroded by increasing debt service cost and deflated land values.

I have seen some lose their farms. And now I and my fellow borrowers are paying the increased interest rates that must be charged if my lender is to cover the cost of carrying those farms on their books--and that's what they have to do because there is no market for those farms. And that higher interest rate only increases the debt service burden of the other farmers, thus weakening their own financial condition. There comes a time at which the increased interest rate becomes non-competitive and borrowers who can find another lender will flee, thereby imposing even greater interest cost for those who remain.

But Mr. Chairman, as a director I can justify forbearance to the stockholder/borrowers of these banks and associations, and to the investors on whom we rely, and I can justify forbearance to my neighbors--**but only** in the context of restored profitability on the immediate horizon. I don't see it.

Instead I see loan officers who are trying to rewrite operating loans amid the prospect of massive withdrawal of government support in agriculture. I also see an Administration that proposes a $50 million tax on farmers' access to the agency market--rising to $75 million in FY '87. Apart from the revenue, their expressed purpose is to continue raising the fee until farmers are driven from the agency market. They call it a user fee for which farmers get nothing in exchange except a higher interest bill.

Mr. Chairman, surely this is an issue over which the Agriculture Committee should assert its jurisdiction, in order to block further movement on this item of the Administration's budget proposal.

Credit is the most important tool in my farming business. My PCA and the Farm Credit System of which it is a part must be kept strong. It is the access that I and my neighbors have to the nation's money market. Without apology, I am concerned about preserving the strength of those institutions, country banks and the small town businesses and institutions that are vital to my business and rural America.

As agriculture goes, so will the institutions of the Farm Credit System. We have done much in recent months to mobilize capital to best assure viability of troubled institutions around the country. I am not concerned about Farm Credit's ability to deal with the current level of stress. The challenge is to stop the deterioration of those credits which do have a chance for survival in the farming business. If we are to do that, the industry needs immediate assistance from government.

Let me commend you and you colleagues for demonstrating, through this forum, that you share the same concerns we have about the well-being of farmers and all of those who serve and depend upon agriculture for their livelihood.

From a policy level I have attempted to outline a farmer/director's perspective on the urgent concerns and commitments of the Farm Credit Council. I have asked Mr. Harling to speak more specifically to these same issues and the proposal we would urge for your consideration.

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Statement of John A. Harling

My name is John A. Harling and I am the Chief Executive Officer and President of the Farm Credit Banks of Omaha. I am also a member of The Farm Credit Council's Legislative Committee, and it is in that capacity that I appear today. Let me talk frankly to you about the deteriorating conditions in agriculture, as I see them from my perspective.

Mr. Tucker has painted a very real picture of what is being faced by many farmers and their lenders today.

Nowhere is the distress more painfully evident than in the Mid-western states like Iowa and Nebraska, which along with South Dakota and Wyoming make up the Omaha Farm Credit District.

Midwestern farmers are caught up in an accelerated restructuring of the agricultural industry. This restructuring is the result of macro-economic changes that are long-range in nature. Agriculture has moved from the inflationary environment of the 1970s to the deflationary environment of the 1980s.

During the '70s--with the rapidly increasing price of oil, increased U.S. agricultural product demand, and other major economic factors--the market focused on exports. An inflation psychology existed, led by expanded world

markets for agricultural products, and driven by a competitive advantage as a result of a weaker dollar. The higher and higher levels of inflation at the end of the decade fueled high interest rates. Good business decisions of the '70s were based upon an attitude of "buy now"--because if you waited, it would cost you more later. At the same time debt costs were low in comparison to other investment opportunities. Farmers responded by increasing productivity, substituting capital for labor, improving farm assets, acquiring more land, and building more facilities--much of which was financed with debt capital. These decisions were further encouraged by the existence of a government safety net and the reasonable expectation of profits over the long pull.

That environment began to shift in the late 1970s and the early 1980s, driven by a strong dollar weakening the competitive position of the U.S. farmer in world markets and high real interest costs--all of which have led to an agricultural industry that is now over capacity. Attitudes in the '80s have shifted toward a deflationary psychology in which the better decisions are to delay purchases because any delay will lead to lower costs at a later date. Debt costs on farm assets are now high in comparison with returns on other investment alternatives. Our weak competitive position in world markets has contributed to a weaker overall demand. That, coupled with an oversupply of agricultural production in all sectors, has driven commodity prices to lower levels. Variable costs have remained reasonable close to the levels during the latter part of the '70s and early '80s.

Consequently, the only way to bring profitability back into agriculture has been through reduced fixed costs. This has created pressure on asset values, particularly land and farm machinery. This pattern has further been

accentuated by the sale of assets to retire debt, as farmers attempted to restructure their own debt management programs to meet the needs of the '80s.

The result has been a massive and accelerated restructuring of the agricultural industry in parts of the country like the Midwest. The industry has moved rapidly to downsize to meet the macroeconomic changes just outlined. Our view is that this is a long-range adjustment and it will continue until profitability returns to the industry. At the same time, the transition is being accelerated with the threat of the safety net of government programs being eliminated. That sends a loud and clear message to both the borrower and the lender--one of still lower commodity prices and net farm income. Faced with this new economic environment, today's farmer has a new set of assumptions upon which to make decisions. These assumptions have impacted his willingness to replace worn out or obsolete equipment, to expand farming operations and to otherwise improve his productive capacity.

This is best described by what has happened to Iowa farmland values since their peak in 1981. We observed, at the beginning of 1985, an average decline in land values in Iowa of 38.3 percent from their peak--with a range of decline from 20 to 50 percent. Some areas are showing more stress than others because of their relative position in the marketplace. Such areas include southern Iowa, northern Missouri, northeastern Kansas, north-central Nebraska, southwestern South Dakota and eastern Montana.

The double barrelled impact of declining asset values, coupled with lower net income performance, has had a dramatic impact on the farmer's balance sheet. In recent months, the Council's task force has teamed up with a similar task

force of Iowa State University economists. Their studies indicate that 8-to-10 percent of farmers nationwide have debt to asset ratios in excess of 70 percent and will be insolvent within two years. It is further distressing to note that this group owes between 25 and 31 percent of all outstanding farm debt but owns only eight percent of the assets.

Iowa State University economists further state that "for this group annual interest cost is about double net income and liquidations seems inevitable." When applied to the total agricultural debt, those percentages suggest there is as much as $66.3 billion of farm debt that falls into that category. Again, using the assumption that those producers who have debt-asset ratios in excess of 70 percent really have no alternative but liquidation, the magnitude of the problem is significant. The public policy question is "how fast can we allow this transition to occur without destroying the rural community?"

We believe that more than the farmer is being impacted. Others feeling the threat of rapid deterioration in the economic environment include rural banks, Farm Credit associations, agribusiness firms including cooperatives, small town retailers and other rural entities.

We in Farm Credit are vitally concerned about the impact of this stress and have taken a number of actions internally to enable us to assist our borrowers in coping with it. Among others:

o System Banks have proceeded with further consolidations of three-bank management, now completed in most Farm Credit districts;

o Realigned territories at the association level to ensure more efficient and effective service to member borrowers;

o Coordinated the delivery of short and long term credit by System institutions during these stressful times;

o Continued to practice forbearance toward borrowers in difficulty by staying with those who show reasonable prospect for recovery;

o Mobilized a task force on credit alternatives working with staff at Iowa State University to assess the impact of current stress and to propose alternatives for responding;

o Demonstrated both commitment and ability of System institutions to address the capital needs of severely stressed Farm Credit institutions and their borrowers by putting together a major program of internal assistance for a district bank.

These actions may be enough for Farm Credit to deal with the present level of stress, but they won't be enough for the industry and they won't be enough for Farm Credit if deterioration continues.

The problem that must be addressed is the lack of income today and the lack of any prospect of income tomorrow. We are not going to solve agriculture's problems simply with cheaper credit, but $4.00 corn and $8.00 soybeans might go a long way to help.

The President's budget assumes that seasonal average prices for 1985 will be $2.60 per bushel for corn, $3.30 for wheat and $6.15 for soybeans. All of which are lower than this season's prices. If farmers are losing money today, does it really make any sense for their PCA to lend them money so that they can lose it on their 1985 crop as well.

From our point of view what is going on in agriculture is like playing Russian roulette with a full load. No matter how many times and ways you spin the chamber, when that trigger is finally pulled the farmer is going to lose, and so will the financial institution that lent him the money to put in his crop.

But for the Farm Credit System, let me take this analogy one step further because I think it helps illustrate the difference between us and the rest of the lenders you will hear from today. When we play that game of Russian roulette--going one more year with a troubled borrower--we are placing farmers in the position of having a fully loaded, double barrel staring them in the face. Not only do we know they are going to lose due to low commodity prices, but since our institutions are fully owned by farmers, when we take a loss on a loan or subsidize a loan the cost of doing so is not coming out of some investor's pocket, it's going to come out of another farmer's pocket--a farmer who cannot afford to pay the higher rates that would be necessary to recoup our losses.

Mr. Chairman, therein lies the major problem with the Debt Adjustment program, or DAP as it has come to be known. Last November the Council submitted recommendations to improve DAP. We were among the many who called for interest write down in lieu of the otherwise required principal write off to bring the loan into performing condition. We are pleased to note the administration's willingness to permit now the interest write-down.

Yet, our poll of the farm credit banks indicates no participation to date and frankly we do not expect any significant level of participation. While a few

can and will participate, the associations whose borrowers most need this relief cannot afford to take the level of write-off needed to bring those loans to performing condition. In most instances they are already carrying non-income producing assets at a level which makes their interest rate non-competitive.

Restructuring is not a new idea. Since 1972 about 50 percent of the Land Bank loan volume has gone for restructuring of farmers debts. Over the last two years PCAs have absorbed over $500 million in losses. The whole Farm Credit System is now paying to support one of its sister FICBs.

What I am saying very pointedly, Mr. Chairman, is that in addition to what they are already having to support, we cannot expect the rest of our farmer borrowers to pay the higher rates necessary to cover our involvement in the DAP--either as it was announced last September or now revised. Our solid borrowers cannot afford those higher rates, and even if they could, it wouldn't be very long before one of these other bankers would be knocking at their door offering them a more attractive rate to lure them away from us.

Frankly, we don't need government guarantees for loans that work. To slow the deterioration of borrowers who have some prospect for recovery, the need is for government assistance in bringing the loan to performing condition--that is, some help for the farmer in meeting or reducing his cash flow requirements.

We don't think that any one program can be a solution to the immediate, let alone the long term problem. We therefore would support a variety of measures

to be put in place immediately that could increase the level of available credit for 1985 operating purposes:

- Revise the DAP program fully along the lines recommended by the Council in the attached letter of November 19, 1984, and in addition provide for a government funded interest subsidy in bringing the loan to performing condition;
- Provide guarantee authority of up to $3 billion to be used not only for DAP but for the more traditional FmHA guarantee programs;
- Target FmHA resources and increased personnel levels to high distress areas,
- Eliminate guarantee fees that must be borne by farmers who are already strapped for cash;
- Alter FmHA takeout procedures to conform with those in place under SBA guarantee programs;
- Permit government to advance to farmers this spring a percentage of the commodity loans they will be entitled to this fall, with the requirement that borrowers meet a credit elsewhere test and participate in the crop insurance program.

Mr. Chairman, we suggest these alternatives for implementation immediately. They would help slow deterioration of many borrowers. A workable guarantee program would provide an additional measure of security to the lenders while helping borrowers in this group to meet their debt service requirements.

But in addition to high interest rates, the borrowing capacity of all of agriculture continues to erode due to the continuing downward spiral of farm asset values. The prospect of significant numbers of farm liquidations and the lack of confidence in the country has gutted the farm real estate market. Not only has the drop in farm land values wiped out the equities and borrowing power of many producers, but the cost of carrying acquired property that cannot be moved on the market is forcing loan interest rates upward thus further aggravating the problem for all farm borrowers.

Mr. Chairman, to restore order to the market for farm asset and to stabilize land and machinery values we would support immediate formation of a limited-life, limited-purpose corporation under federal law. It would be a mixed-ownership corporation. This federally chartered Agricultural Conservation Corporation (ACC) would be empowered to purchase the farm assets of distressed farmers and their lenders, including the Farmers Home Administration. It would lend much-needed stability by holding and disposing of these properties under local direction, and in an orderly manner over a specified period of time.

Who stands to benefit under this concept? More than anyone else, farmers would benefit from a return to liquidity in the land market. Land is the principal base of wealth in the farming sector. According to Iowa State economists, the land in that state and in neighboring states has already fallen to or very near economic levels under current income prospects in agriculture. Yet values continue to fall. In much of the midwest, if a farmer wants to sell a a portion of his land to help reduce his indebtedness, he cannot find a buyer. Stopping this downward spiral alone will prevent farmers who may have thought they had a secure equity position from quickly

sliding into an unsecured position. The ACC would facilitate the voluntary transfer of excess real estate. And as the result of the ACC taking over the carrying costs of these non-performing assets, lenders will no longer have to pass these costs on to borrowers through higher rates. Farmers would also benefit by virtue of the fact that many are themselves contract sellers. Perhaps most importantly, by holding land out of production, the ACC could significantly contribute to a much needed land reserve thus reducing production and enhancing the profit outlook for all of agriculture.

Here are some of the essential features of ACC, as we envision it:

o The corporation would be capitalized primarily by its users, ie. those lending institutions and individuals who transfer property to the corporation. In exchange for the transfer of land or machinery to the ACC, they would receive only a portion of the value in cash; the remainder, they would receive in stock. Additional capital might come from state governments as well as individual investors.

o The corporation would have the authority to issue government-guaranteed debt instruments.

o The corporation would be authorized to acquire farm assets--including real estate, machinery and equipment--at fair market value.

o Property so acquired would be held off the market, managed (perhaps out of production) and disposed of under the direction of local committees.

o It could be operated through farm credit associations or other local lending institutions whose services are provided on a contract basis.

o It has the potential initially to return a substantial amount of capital to the U.S. Treasury and provide annual savings through reduced interest costs.

Mr. Chairman, we believe that this measure of intervention is urgently needed to restore order and reason to the market for farm assets. We believe this option should be vigorously pursued. Our task force is eager to work with members of this Sub-committee and their staff in order that legislation might be offered to establish this entity at the earliest possible time.

Mr. Chairman, we in Farm Credit are vitally concerned about the current level of stress in agriculture. There is a feeling of despair that is filling farm homes, small town businesses and loan offices. There is a crying need for a signal from government that would restore some confidence to the farming sector. This we can do for a time through interventions such as those we've suggested. But these alternatives, like forbearance, can be rationalized only in light of a prospect for restored profitability in agriculture.

Mr. Chairman, we pledge our assistance in working to urgently and productively respond to the issues before this subcommittee.

I very much appreciate the opportunity to appear on this panel with Mr. Tucker and Mr. Banner today on behalf of the farmer-owned institutions that hold a third of the nation's farm debt.

We would be happy to respond to your questions.

THE FARM CREDIT COUNCIL
1800 MASSACHUSETTS AVE, NW · WASHINGTON, DC 20036 · 202/466-4180

November 19, 1984

Chief, Directives Management Branch
Farmers Home Administration, USDA
Room 6348, South Agriculture Building
14th and Independence Avenue, S.W.
Washington D.C. 20250

Subject: Interim Rule on FmHA Guaranteed Loan Programs, 7 CFR Part 1980

Gentlemen:

For The Farm Credit Council, this is to provide comments on the interim Rule published in the Federal Register of October 19, beginning at page 41223.

Through the efforts of leaders among the nation's Farm Credit Banks, The Farm Credit Council was created late in 1982 as the federated national association of Farm Credit Banks, associations and other cooperative farm lenders. Through its federated membership of twelve District Farm Credit Councils, its membership includes all 37 Farm Credit Banks and some 85 percent of the production credit associations and Federal land bank associations nationwide.

With more than $80 billion in loans presently outstanding to over a million of our nation's farmers, ranchers and commercial fishermen and their cooperatives, these institutions hold approximately one third of the nation's farm debt. They are vitally interested in the subject matter of these proposed regulations. Pursuant to direction of the Board of Directors of The Farm Credit Council at its October meeting, the Legislative Committee of the Council established a special task force on Credit Alternatives for the Short Term which has carefully studied the interim rule of October 19. These comments are based on that study.

Agriculture is in a state of transition. During this period of transition, there is an urgent need for restored confidence which would help stabilize deteriorating farm asset values. Time is essential not only for farm borrowers but for their lenders as well, if they are to successfully and orderly manage their affairs through this stressful period. We recognize that during this period, borrowers, lenders and government must work more closely than ever to assist financially troubled borrowers and where possible seek to increase the number who have a reasonable chance for financial viability.

We welcomed the President's response on September 18 to the economic problems facing farmers and ranchers in much of the nation. The special set-aside program should help to provide a measure of needed additional time and stability where many FmHA borrowers are concerned. The Debt Adjustment Program (DAP), however, can only assist those borrowers whose lender elects to participate.

Based upon our contacts with member Farm Credit banks and associations and with other commercial agricultural lenders, we conclude that, as announced, the DAP will be of minimal help to lenders in their efforts to serve the financing needs of their farm borrowers. Our principal concern, therefore, is to minimize operational obstacles that are sure to impede acceptance of the new guarantee program by many farm lenders. Accordingly, we offer the following comments and suggestions.

FIRST, paragraph I,A of the new Exhibit B includes the requirement that ". . .the lender must actually write off, by permanent cancellation, at least 10 percent of the total principal [plus an additional amount of principal as is] sufficient to provide a positive cash flow projection necessary to service all debts, pay all operating expenses and provide for family living expenses." Paragraph II,B of the new Exhibit B provides that "The lender will not be permitted to substitute a reduced level of interest rate charge in lieu of an additional write off to create a positive cash flow." These provisions should be stricken or amended to provide that, in the alternative, the lender may bring the loan to a positive cash flow position through a downward adjustment of the interest rate.

The basic thrust of the DAP should be to offer the government's guarantee as an inducement for the lender to restructure a non-performing or classified loan to the point it can perform. To require that this be accomplished only through the forgiveness of loan principal is to arbitrarily limit the options available to the lender for achieving this goal while reducing lender acceptance of the program.

We believe the program should not constrain, but should encourage lender and borrower creativity in managing credit in these difficult times. We strongly believe this change would result in greater participation. Clearly no farmer can be helped if his lender does not participate.

SECOND, paragraph I,A states, "The amount written off must be sufficient to provide a positive cash flow projection necessary to service all debts, pay all operating expenses and provide for family living expenses." However, later in the same paragraph the rule states, "For the purposes of this Exhibit a positive cash flow is a cash flow (as defined above) which reflects a balance available of at least 110 percent of the amount needed to pay all the year's debts due including tax liability." We believe some further clarification is needed as to just what a positive cash flow means for the purposes of DAP. It should be noted that many loans not classified as troubled loans at the present time are having difficulty making cash flows of 110%. We question whether a positive cash flow under DAP should include a 10% surplus over what is necessary to pay all of the year's debts including tax liabilities and family living expenses.

THIRD, subparagraph I,B(2) provides that whenever possible the guarantee will be set at less than 90 percent of the loan ". . .to assure an appropriate sharing of risk between the private lender and the Federal Government. A guarantee of 75 to 80 percent is an appropriate guarantee level." The guarantee should be set at 90 percent and all reference to guarantees of less than 90 percent should be deleted.

By including a statement delineating what is an "appropriate" level of guarantee in the rule, clear direction is given to FmHA staff that any guarantee level greater than the 75 to 80 percent level would be inappropriate. Once the lender has absorbed principal and/or interest sufficient to permit a positive cash flow (with a 10 percent margin for error) we do not believe that a guarantee of 75 to 80 percent is an appropriate sharing of risk. This lower level of guarantee will only serve to discourage participation in the program.

FOURTH, paragraph II,E requires payment of a 1 percent guarantee fee. The fee should be waived. We believe that imposition of the guarantee fee will frustrate the objective of assisting distressed farm borrowers. If the fee is passed on to the borrower it only adds to the financial distress of the already severely troubled borrower. If the Farm Credit lender cannot pass the fee on, it will only add to the costs of the loan loss that must be borne by the remaining member/borrowers of the bank or association.

After the lender has forgone principal and/or interest sufficient to make the loan cash flow, we see little justification for imposition of a fee to compensate the government for its partial guarantee of a then performing loan. In either event, the fee serves as a disincentive for participation in the program and should be stricken.

FIFTH, we urge that take-out procedures under the FmHA guarantee programs be revised to conform more nearly to those employed under loan guarantee programs of the Small Business Administration.

There has been a longstanding perception that FmHA loan guarantees are very difficult to collect against. This has clearly acted to discourage participation. At the very least, we believe FmHA could help to dispell this perception by following a regular practice of disbursing partial payment against the guarantee prior to the completion of loan liquidation.

We do not believe that any of the changes we have proposed would substantially alter the intent or the purpose of the interim rule as published October 19 and would not, therefore, delay further implementation of DAP. In fact, if the program were to be revised as we have proposed, it would gain wider usage and better serve farmers and lenders alike.

Again, we appreciate the opportunity to comment on the interim rule. We in Farm Credit are most eager to work with the Administration in addressing needed changes in the programs as announced and to explore additional programmatic options which could significantly raise the level of program acceptance by cooperative and commercial lenders alike. We would be happy to provide any clarification of our comments you might desire.

Yours respectfully,

John White, for

Delmar K. Barner
President

THE FARM CREDIT COUNCIL

ISSUE 11 **Credit Alternatives and Long Term Profitability in Agriculture**

RESOLUTION

Credit Alternatives and Long Term Profitability in Agriculture -
As the result of low commodity prices, natural disasters, high interest rates, and sharply declining asset values, American agriculture is experiencing severe economic stress. These conditions are hastening and intensifying a major transition in agriculture -- its structure, production capacity, and markets.

During this stressful time, many farm borrowers are encountering severe debt repayment problems. Consequently, many farm lenders are also experiencing extreme financial stress. We believe that current conditions are so severe that extraordinary efforts will be required by all parties--borrowers, lenders and government--to achieve an appropriate solution. Any effort to address the immediate problems must recognize that:

o Agriculture's transition must be evolutionary and not revolutionary. Both borrower and lender alike need sufficient time to successfully adjust.

o The institutions serving agriculture must find short-term alternatives to normal operations that will facilitate transition in an orderly manner that is both compassionate toward borrowers while preserving of those institutions on which agriculture must depend in the future.

o Private sector farm lenders are borrowers too. Their ability to attract the necessary loan funds to serve agriculture is dependent upon their own financial strength. In order to maintain that strength, lenders must operate on sound business and credit principles.

o Many of the current problems in agriculture have been prompted by international and macro-economic policies of government in recent years. Therefore, government should participate substantially in the short-term programs necessary to facilitate that transition.

o The use of government and private resources is best determined at the local level and on a case-by-case basis.

Specifically, to address the immediate borrower and lender problems, The Farm Credit Council will support legislative and/or regulatory alternatives which will stabilize farm asset values, and permit the government to assume a greater share of the risk of farm financing while providing the support necessary for lenders and those borrowers who have a reasonable chance of recovery to adjust during this time of transition.

Agricultural credit alternatives for the short term, however, will be futile without the prospect of long-term profitability for U.S. agriculture. Credit is no substitute for income. As the representative of those farmer-owned organizations which hold a third of the nation's farm debt, it is incumbent upon The Farm Credit Council and its member organizations to aggressively communicate to the Congress and the American public the message that "profitability must be restored to the farming sector; it is vital to the economic and social health of America." (1st Adopted 1/22/85)

THE FARM CREDIT COUNCIL'S

PROPOSED

AGRICULTURAL CONSERVATION CORPORATION (ACC)

Purpose

To return profitability to agriculture, to conserve fragile land resources, and to stabilize farm asset values through a long-term land retirement program.

Key Features

1. Federally chartered, limited life, limited purpose, mixed ownership corporation.

2. Empowered to buy farm assets from lenders and distressed farmers at fair market value. Assets to be purchased may include real estate and machinery and equipment. Regionalized asset evaluation mechanism to be established to determine fair market value of assets purchased.

3. Corporation managed by a board of directors which is accountable to the equity holders including the government.

4. Equity capital may be owned by users of the corporation including commercial banks, farm credit institutions, USDA, insurance companies, contract sellers, and others. Additional capital may also be generated from state governments and/or private investors.

5. Stockholders' equities will be held in proportion to assets transferred to the corporation.

6. Assets may be acquired for up to five years; assets must be disposed of within ten years or less.

7. Operating expenses supported from the income from investments in government securities equivalent to 10 percent of the outstanding value of farm assets held by the corporation.

8. All debt issued by the corporation would be guaranteed by the U.S. government.

9. Land retirement requirements as determined by the government to apply to all real estate owned by the corporation.

10. Corporation management provided on a contract basis (the Farm Credit System is a possible provider of this management service).

11. Assets to be disposed of when sale proceeds exceed value at which asset is booked plus selling costs. Assets must be put on the market when market values reach 115% of the value at which the asset was booked.

Example Financial Structure

Assets:		Liabilities:	
Farm Assets Owned	$10 bil	Outstanding Bonds (guaranteed by U.S. govt)	$9.5 bil
Government Investments	1 bil		
Total	$11 bil		
		Equity: (15% of assets)	1.5 bil
		Total	$11.0 bil

Pro Forma Income and Expense

(Assuming no gains or losses on sale of assets)

Income:		
$5 bil of assets x 10.0% rental return	$ .50	bil
Supplemental Land Retirements Payments from U.S. government at 10.0%	.50	bil
Investment Income	.10	bil
Total Income	$1.10	bil
Expenses:		
Operating Expenses	$ .100	bil
Interest on Outstanding Bonds ($9.5 bil x 10.5%)	.9975	bil
Total Expenses	$1.0975	bil
Net Income:	$2.5	mil

Financial Impact on U.S. Government

It's assumed that one-half or $5 billion of the acquired assets would come from the FmHA portfolio. Deducting one-half of the equity investment or $.75 billion, the Federal government could reduce its outstanding obligations by a net of $4.25 billion at an average debt cost of 10.50% this would represent an annual savings to the government of $446.25 million. Additionally, the U.S. government is currently spending approximately $1 billion a year for land retirement programs. Thus the total savings to the government should equal approximately $1.45 billion, less the supplemental land retirement payment of $.5 billion, or a net positive cash flow of $946 million per year.

The acreage included in the real estate held by this corporation could easily be in excess of 16 million acres in the example set forth above. Thus there is a significant opportunity for a major land retirement in these assets alone under terms and conditions established by the government. The governmental savings referred to above could be diverted to this corporation as illustrated in the above income and expense statement. Thus the positive impact on the federal budget would be indeed quite significant.

Disadvantages

It is recognized that there are some definite downside features of this proposal. Among the more obvious are the following.

1. The reluctance to concentrate land in one entity.
2. The reluctance of potential buyers to allow an artificial floor.
3. This plan does not keep all farmers on the farm.
4. There may be short-term adverse effects in the agribusiness community.

Benefits

It is felt that there are numerous potential benefits to be derived under this concept. Among the potential benefactors are the following.

1. Farmers - whose security base, upon which loans are obtained, is steadily eroding due to the rapid devaluation of farm assets.
2. Farmers - whose cash flow can be improved through the voluntary transfer of excess real estate and the debt service associated therewith.
3. Lenders - by easing the burden of ownership of acquired properties and nonperforming loans this will aid in maintaining the financial stability of the lending institutions it will lower the cost burden on the users of those institutions and it will increase the lenders effectiveness in providing financial services.
4. Agricultural community - the welfare of the entire ag business community will be enhanced in the long run by stabilizing the farm asset base and by serving to improve long-range profitability through the land retirement aspects of this proposal.
5. Government - the ACC will provide a mechanism to make a notable transition of FmHA accounts and other loan assets where there are no other reasonable chances for recovery.

Senator PRESSLER. Thank you very much.

Now if the PCA's and the Federal land banks continue to experience losses, what impact will that have on other borrowers in the entire system? Will this raise interest rates or how is the gap going to be made up?

Mr. HARLING. We believe that that is true in the case of all lending institutions, that when there are losses, they get passed on to the other borrowers of that institution, whether it is a farm credit institution or any other lender, through higher interest costs. Eventually they have to be absorbed by the organization.

In the cooperative farm credit system where the farmers are the stockholders and owners of the system, they get the double barreled impact of that through higher interests costs eventually.

Senator PRESSLER. Now what is the Federal Land Bank's policy in regard to farmland that is acquired through various procedures?

Mr. HARLING. We have three different organizations that we are working through to move that land onto the market at the present time. However, that policy provides for the withholding of that land in any particular area where the values of that particular land might indicate that it is a soft market. In other words, we would not put land on the market where we would envision that putting that land on the market might drive the values even further down.

Senator PRESSLER. How much help will what the Secretary of Agriculture announced yesterday provide to the PCA's and Federal Land Banks directly or indirectly?

Mr. HARLING. The program that was announced back in September has not been effective insofar as farm credit associations are concerned, and I doubt that it will be used very much even though we have encouraged our associations to use it. We have a difficult time in making the program work because of the cash flow requirements and the amount of loans or interest that is required to be written off before those loans will work. For loans that work, we don't need guarantees.

Senator PRESSLER. Yes. Well, that is something that has struck me as unusual about this whole thing. This program was reannounced sort of. It has been in existence since September, but very little of the money has been used. Some people might say, well, there has been $700 million sitting there and nobody has used it. But it is structured in such a way that I don't think anybody will.

Mr. HARLING. That is our view, too, and we believe that the amount, if the program were used, would not be adequate to handle the amount of the problem. It is more in the neighborhood of $3 billion that would be needed instead of the amounts that are available.

Senator PRESSLER. If the present agricultural situation continues, what is going to happen to lending institutions? Would you give a description if it continues for another year or two?

Mr. HARLING. Well, we are already seeing the pressure on both the farm credit associations and particularly the small local commercial banks. As those losses come into the portfolio and are written off, that brings continued pressure on earnings, continued pressure on capital and ultimately, if the losses continue, the organization will run out of capital base and will be forced into liquidation.

We have had two PCA's that are in liquidation right now in north central Nebraska. We have several others that are suffering financial stress, and we are doing all that we can to prevent that from happening. But there will be more if we don't take some extraordinary steps to prevent that from happening.

We have, for example, in the Omaha district loss sharing agreements between the PCA's. Those have been triggered now 2 years in a row in which the financially sound and strong PCA's provide capital to the others. The next step is to turn to the credit bank itself for financial assistance, and that is occurring now. But in both cases you can only go about so far and then you start adversely impacting all of the other borrowers, and you can't raise your rates to the point where you put that next round of borrowers through the ringer until their loans won't work any more.

That is what we are seeing happening, that downward spiral as the pressure of increased costs of funds and losses comes to bear on interest costs.

Senator PRESSLER. Now at some point that snowball becomes catacylsmic or it reaches a point where the whole system collapses. How far away are we from that?

Mr. HARLING. Well, as I have said, we have triggered the loss-sharing agreements 2 years in a row and now we are providing financial assistance out of the credit bank. We have an agreement between the other bank and the farm credit system to provide assistance to banks in distress.

We don't know the answer to your question, frankly, but we believe that we are a ways away from that yet, but the problem is accelerating and is growing in magnitude. And we believe that some significant action needs to be taken and very soon, the sooner the better, to keep that from happening.

Senator PRESSLER. Now in relationship to what you have said, you have pointed out that these are farmer owned, so to speak, ultimately the losses would be to the farmer owners or to the people who are participating or have participated.

Mr. HARLING. That is right.

Senator PRESSLER. I think you have outlined the problem and also made some positive suggestions.

I didn't ask our two bankers from South Dakota what steps you recommend. We have heard many recommendations here today, but what would you suggest that Congress and the Federal Government should do at this point?

Mr. NORDSTROM. Well, I have to agree with one point, that this is an income problem more than a credit problem, and some income in there will solve these credit quality problems that we are looking at. Fifty cents a bushel on oats would do a lot more than some of these other maneuvers. So it is a matter of getting the income back into the farm section.

Senator PRESSLER. It is a price situation.

Mr. NORDSTROM. Pricing is part of it. It is income to go back there. You know, we can fight all we want over the size of the pie, but the pie has got to get bigger because we need a big pie to support what has happened out there, and the pie did not grow large enough to cover either the interest costs or the energy costs that came back into farming here years ago.

This isn't something that happened now. It took maybe 10 years for that energy cost to go all the way through the system and down to the farmer. That is a lot of our problem. He has been locked into a high energy cost. You look at an irrigation unit, and basically what is does is help put all forms of energy with sunlight to grow corn, at a price in excess of the current market. That created a tremendous amount of problems.

And this probably was compounded a little bit by giving the investment tax credit to nonfarmers, but nevertheless it is what happened. Energy got too expensive, and this came at the same time we had a compounding interest factor in the farm situation with prices where the gross income is no higher than it was in 1972.

So if we can turn around and help on the income side, I think we can get at some of the other problems sooner. We need time to get this balance sheet in order.

Senator PRESSLER. John, what are the land values in your community and how does it compare to 5 years ago?

Mr. HAERTER. We haven't had very many land sales now. So I don't really know what they are selling for now. But I would guess roughly the better land up in our area was selling for around $350 an acre and it is probably down to $225 now.

Senator PRESSLER. So what percentage drop is that? What was it 5 years ago?

Mr. NORDSTROM. About $350 and it is down to about $225 now.

Senator PRESSLER. So it is a third.

Mr. HAERTER. Yes. You know, like I said, there really isn't that much land being sold. I know the FHA has some land that they are trying to sell, but they are not making a big effort because they would have to sell it too cheap. So rather than do that, they are just holding onto it. And the rest of the land that would be for sale or is for sale occasionally, if it were say a good quarter of land, there is a little bit different situation there. You are going to have people that may live out in California that used to live in our area and they will probably buy a quarter of land just because they think it is a good investment. They don't know what is really going on I guess, but that is their problem. [Laughter.]

Mr. HARLING. Senator, I have some figures on land values in South Dakota, if that would help.

Senator PRESSLER. Yes.

Mr. HARLING. For example, the range of adjustment from the peak when land values peaked is from as little as 2.8 percent drop to as much as 67.1 percent drop. The average for the State from that peak, the average drop is 18.6 percent. Now that is using land bank benchmark farms, but I think it is indicative of what has been going on up there.

Frankly, there are some folks in Iowa that would be very happy with that little drop. The drop has been more significant in Iowa.

Senator PRESSLER. Because that is where you had the big dramatic prices, Indiana, Iowa and Illinois, some of that land that was $2,000 and $3,000 just couldn't stand up to that.

Mr. HARLING. Right.

Senator PRESSLER. How much lower do you think farmland will go?

Mr. HARLING. Well, if I looked enough in here I think I could find some projections. It does presume that we have to have profit back before you will have stabilization. I may not have those figures for South Dakota.

Senator PRESSLER. Well, for Iowa or any place——

Mr. HARLING. Here is the one right on top which is Benton County, IA. It is over by Cedar Rapids, very productive land. The corn yields on the average on this farm are 145 bushels per acre and soybeans at 45 bushels per acre.

This particular farm at its peak was priced at $3,750 an area. On January 1 it had dropped to $2,350 an area. And if you use a scenario from $2.35 a bushel on corn and $5.60 on beans, which is the most pessimistic of these runs, that land could drop to nearly $1,000 an acre.

If you want to get more optimistic on commodity prices, you can get it up to $2,000 an acre, but it means that it still has $300 an acre to drop before it starts to work, and then it depends on what percentage you want to use on what is an adequate rate of return.

Senator PRESSLER. So we may be just half way through the drop. I mean if we are assuming that it goes down to $1,000 an acre, it is less than half way there. So, in other words, assuming no increase in commodity prices, we are just half way through the depression in farmland prices which would put even more pressure on banks and lending institutions.

Mr. HARLING. If it goes to $1,000 an acre there won't be very many farmers left around to farm.

Senator PRESSLER. It will go to $1,000 an acre if commodity prices remain at current levels?

Mr. HARLING. If you pull the safety net out and let that free fall, let those commodity prices free fall, that is what we believe will happen.

Senator PRESSLER. That is very significant. If we pull the safety net out, and the safety net is the target price program; is that right?

Mr. HARLING. It is the program in some fashion or another that provides some assurance that there is a bottom.

Senator PRESSLER. Well, I think that is very significant testimony. I think those of us in the Senate and House should heed that and act.

I have proposed some very specific farm legislation, as have others, both affecting international trade and domestic pricing. I am not going to go into that today for lack of time, but have discussed it on the Senate floor.

I do want to thank you very much for the information you have brought here. I am going to be in my State next week at several farm meetings, and we will be holding a meeting in this subcommittee on the impact on small business on the main streets of our small towns.

I think we have heard today that we have just a very severe crisis in the credit area. In my view, it is closer to collapse than probably people like to admit because they don't want to cause panic or depressed feelings before they have to. But from what I have heard here today, we are very close to a collapse of the credit system in rural America, in my view.

What I have heard here today has made me even more alarmed than I was at the beginning of the day about these matters.

Your testimony is much appreciated and I thank you very much.

I am told we have lost to an airplane or something our folks from the Independent Bankers Association, but I want to submit their plan for the record. They have submitted a specific plan and I shall place that in the record.

[The credit plan referred to of the Independent Bankers Association follows:]

IBAA Farm Credit Proposal
(Approved February 5, 1985)

The IBAA proposal is composed of two parts:

1. For the $650 million Farmers Home Administration operating loan guarantee funding approved by Congress during August-September, 1984, eliminate any administrative requirement that commercial lenders "forgive" part of the principal or interest as a prerequisite for a loan guarantee. This can be done by Administrative action. When all "forgiveness" requirements are removed, we recommend that Congress should increase the funding for loan guarantees from the $650 million to $3 billion--before the existing $650 million is exhausted. When Congress provides additional loan guarantee funding, it should be provided in addition to maintaining the FmHA direct/insured farmer loan programs at their full strength, not as a partial alternative to those programs.

2. Congress should provide on an expedited basis for a joint Federal-Private Lender program to "buy down" the interest rate for certain qualifying farmers' debt where the debt would not cash flow successfully after restructuring with an FmHA loan guarantee.

Specifically, at the initiative of a commercial lender and farm borrower--

(1) the commercial lender would extend credit to the farmer at an interest rate reduced by two percent below the commercial rate that would otherwise apply; if

(2) the Federal government (Farmers Home Administration) offers to match the lender contribution with an additional two percentage point buydown. We recommend a Federal appropriation of $100 million for the Federal contribution, and that the Federal contribution be limited to $100 million.

Individual States should also be encouraged to contribute with a further buy down of the interest rate to farm borrowers under this program, in the case of loans made under the program within the specific State involved.

Further Comments on Each Part

1. FmHA Loan Guarantees--elimination of "forgiveness feature and increase in funding

In order that the FmHA loan guarantee program will not be further discredited, the administrative requirement that lenders "forgive" principal or interest as a prerequisite for a loan guarantee would be eliminated. The forgiveness feature was added administratively and can be removed by administrative

action. Commercial lenders are already exposed to risks which offset any benefits to them from an FmHA-guaranteed loan, due to: (1) the unguaranteed portion of the loan; (2) the refinancing, which accompanies a guarantee, in an uncertain financial climate in the agricultural sector; and (3) the strict collateral-maintenance requirements under an FmHA-guaranteed loan. Given those risks and the limited present capacity of agricultural banks to absorb additional losses without impairing their capital requirements, commercial lenders generally cannot be expected to participate in an FmHA loan guarantee program unless the forgiveness feature is removed.

As Congress provides additional loan guarantee authority, buyond the $650 million, it is critically important that the additional guarantee funds be in addition to maintaining the FmHA insured farmer loan programs at their full strength. No substitution of guaranteed for insured lending should occur. If insured lending were to be curtailed at this time, many existing borrowers from the FmHA who cannot qualify for commercial credit could be left without a financing source--with the further result that additional farm assets may be forced onto an already over-saturated market.

2. Federal-Private Lender joint interest rate buydown

The $100 million Federal expenditure limit would enable $5 billion of farm loans to be included in the four percent buydown program, assuming for instance loans of one-year duration and full usage of the $100 million ($5 billion x 2% = $100 million).

Senator PRESSLER. I thank you very much, and I will conclude this hearing unless someone has something for the record.

Mr. LESSER. Senator?

Senator PRESSLER. Yes.

Mr. LESSER. The American Bankers would like to submit for the record a statement, too. Olan Tubbs had to catch a plane at 4 o'clock.

Senator PRESSLER. OK, fine.

We appreciate that very, very much.

Should he wish to testify at our next hearing, we will look forward to hearing from him. We may catch up with the Independent Bankers at our next hearing also.

Thank you very much.

[Whereupon, at 4:15 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[The prepared statement of the American Bankers Association follows:]

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

American Bankers Association
Proposal for
Emergency Agricultural Debt Restructuring

February, 1985

Our Concerns

The American Bankers Association (ABA) represents more than 95% of America's banking assets. Approximately 5,200 banks are agriculture banks having more than 20% of their assets invested in auriculture loans. ABA's Agricultural Banking Division serves the legislative, professional, and educational needs of America's agricultural banking community.

Today, American agriculture is experiencing financial problems. There is clear evidence of declining land values and almost nonexistent farm real estate market in some areas. Farm commodity prices continue at very low levels, depressing farm income, and classification of agriculture credits are increasing at commercial banks.

These conditions are particularly prevalent in a number of midwestern states: Illinois, Iowa, Kansas, Minnesota, Missouri, North and South Dakota, and Nebraska farmers and farm lenders are beginning to experience severe losses.

According to various sources, 200,000 farmers or approximately 10% of the 2.4 million farmers in the U.S. could well be out of business within 4 years. The financial distress is most severe in the medium-sized farms ($40,000 - $499,000 annual sales) having debt/asset ratios above 40%. Ten percent of all farmers fall in this category.

ABA recognizes that the problems are both short-term and long-term. The banking industry seeks to be a partner in the policy decision making for three main reasons:

- Agricultural banks are an integral part of the rural community, and we must attempt to provide the skills and economic climate in which farmers, businessmen, and related customers can survive and prosper.

- Agricultural banks seek to manage and supervise various agricultural loan portfolios.

- Agricultural banks strive to maintain long-term profitability and to stabilize the land and chattel asset base in agriculture.

The purpose of this paper is to address the current credit needs facing agriculture. The recommendations are administrative in nature except for our recognition of the need for additional Farmers Home Administration loan guarantee authority. The ABA has developed its positions on this country's long-term agriculture policies which will be submitted as testimony during the upcoming 1985 Farm Bill hearings.

Emergency Response to the Agricultural Credit Situation

The ABA supports an "interest rate write-down" program as the quickest and most effective response to the current agricultural credit situation.

On October 19, 1984, the Administration announced a Debt Adjustment Program for Guaranteed Loans (DAP). In comments submitted to the Farmers Home Administration on November 19, 1984, (letter attached), the American Bankers Association stated that while the Association supported the DAP in principle because it might allow some lenders to continue to provide credit to farmers, "...lenders with portfolios concentrated in loans to agricultural producers simply will not be able to financially accomodate the devastating impact on capital that would result from extension of this program to the growing number of borrowers who need relief." (ABA Comment Letter, November 19, 1984.)

Evidence now supports our Association's position. Despite a rapidly deteriorating agricultural credit situation and a great interest on the part of bankers to aid their agricultural borrowers, there has been little use of the program.

Under the terms of the Administration's Debt Adjustment Program for Guaranteed Loans, up to 90% of the remaining principal and interest on operating (OL) and farm ownership (FO) loans would be guaranteed by the Farmers Home Administration following a permanent "write-off" of not less than 10% of the outstanding loan balance.

The major difficulty banks face if they participate in the Administration's current program is an immediate reduction in capital. If small country banks write-off loan principal, the write-off will be charged against bank capital accounts.

If write-offs of principal are large enough, they may reduce bank capital below the capital adequacy ratios acceptable to bank regulators. Agricultural banks are particularly sensitive to bank examinations at present because many small banks are being forced to sign cease and desist orders and other enforcement agreements that place onerous burdens on the banks and their management until capital positions are returned to normal levels. If an interest rate alternative to the existing program were adopted, this capital problem for small banks would be avoided and the banks could assist more agricultural borrowers.

Program Recommendation

The American Bankers Association proposes the following interest rate write-down program as an emergency response to the agricultural credit situation. We are recommending that the following changes be made in the USDA Debt Adjustment Program for Guaranteed Loans either by administrative action or legislative directive:

- Lender agrees to reduce the interest rate on agricultural loans (existing indebtedness and current operating expenses) from the market level to a rate no greater than the corresponding rate for similar categories of Farmers Home Administration direct loans.
- Federal loan guarantees of 90% of the principal be provided for qualifying loans.
- If the borrower can achieve an acceptable cash flow situation with this interest rate write-down, lender agrees to enter into an agreement with the borrower to provide credit for five years provided customer remains financially viable.
- Existing obligations and operating credit for the next year would be combined under one rate with the terms of amortization tailored by the borrower and lender in each individual situation.
- Acceptable cash flow means 100% of the amount necessary to pay current year's operating expenses, schedule debt repayment, and reasonable family living expenses. During the guarantee period, borrower must adhere to a closely monitored, austere, operating program that foregoes all but the most necessary capital expenditures.
- Participating loans would be reviewed annually by the lender and the Farmers Home Administration. If borrower can regain a position of unassisted profitability during this five year period, lender would have the option of discontinuing guarantee and the interest rate write-down. If borrower is determined not to be financially viable under the terms of the loan agreement, FmHA and lender may discontinue providing credit and take appropriate action.
- FmHA would utilize the approved lender process for determining eligibility and loan approval.
- The Secretary of Agriculture would direct the Farmers Home Administration to make available additional field personnel and equipment to assist in the timely processing of loan applications.

Conclusion

The ABA recognizes the critical situation facing an already overburdened FmHA county staff and strongly supports the approved lender process as a viable method to assist both FmHA staff and ultimately the farm borrower with better financial service in a timely manner. Currently, the Small Business Administration's guaranteed loan program and the Guaranteed National Mortgage Association Program, through certified and preferred lender procedures, operate effectively with minimum government supervision. The FmHA approved lender program has the same potential to streamline the Federal agricultural credit process.

Adding an interest rate write-down alternative to the existing principal write-down would provide agricultural banks with a means of responding to escalating demands for credit to put crops in this spring. It would be an initial, short-term response to the tight agricultural credit market. This program would not require direct outlays this year because it would be funded by FmHA loan guarantee authority, establishing a contingent liability for the federal government.

The objective of the program is to provide farmers who have the potential of survival with the opportunity to return to profitability during a period not to exceed five years. Some will be successful and some will not. However, given the dramatic rate of adjustment in the agricultural economy occurring at this time, without such a program many family farmers with previously successful operations face insolvency now.

This program provides a balancing of private sector forebearance and government assurance to assist the recovery of American family farmers.

This paper has only proposed an immediate response to the short-term agricultural credit situation and the need for an interest rate write-down program, but the ABA has other concerns in this agricultural credit area as well. We are working with the regulatory agencies to get a broader recognition and understanding of the agricultural situation.

Additional Information

The staff of the American Bankers Association or the bankers of the Association would be pleased to answer your questions or provide you with any additional information you need. The Washington ABA Government Relations staff familiar with the issues discussed are:

Denis O'Toole (202-467-6655)
Director, Legislative Operations

Rusty Jesser (202-467-4250)
Legislative Representative

Floyd Stoner (202-467-4253)
Legislative Representative

Ann Free (202-467-4930)
Legislative Representative

Comparison of "Interest Rate Write-Down" and "Principal Write-Down"

Assumption: Farmer has $250,000 of secured debt at an interest rate of 13%. This debt includes an operating loan for this spring's planting.

	Reduce Interest Rate by 4%	Reduce Principal By 30%	
Loan	$250,000	$175,000	
Interest Rate	9%	13%	
Annual Interest Payment	22,500	22,750	
Net Savings to Borrower	10,000	9,750	
Reduced Earnings to Bank	10,000	75,000	
Plus 1% Initial Guarantee Fee	2,500	1,750	
Total Impact			
Bank 1st Year	-12,500	-76,750	
5 Years	-52,500	-76,750	+Interest
Farmer 1st Year	+10,000	+9,750	
5 Years	+50,000	+48,750	

The central point to be made by this example is that the outcome for a farmer is virtually identical under both approaches, but the borrower benefits almost dollar for dollar for every dollar the banks give up under the interest rate write-down. Further, banks will participate in much greater numbers under the interest rate write-down.

AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
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EXECUTIVE DIRECTOR
GOVERNMENT RELATIONS

Gerald M. Lowrey
202-467-4077

November 19, 1984

Chief, Directives Management Branch
Farmers Home Administration
USDA
Room 6348
South Agriculture Building
14th and Independence Avenue, S.W.
Washington, D.C. 20250

Re: Debt Adjustment Program
for Guaranteed Loans

To the Chief:

In response to the interim rule published in the October 19, 1984, Federal Register regarding the addition of a debt adjustment program (DAP) for guaranteed operating (OL) and farm ownership (FO) loans, the American Bankers Association is offering these comments. The Association expresses no opinion on the Interim Rules regarding Special Debt Set-Asides of Farmer Program Borrowers that also appeared in the October 19, 1984 Federal Register. The American Bankers Association is the national trade and professional association for America's Full Service Banks. The combined assets of its nearly 13,000 member banks represent approximately 95 percent of the total industry assets.

The proposed regulations will allow the Farmers Home Administration (FmHA) to provide lenders of FO and OL loans with a guarantee of not more than 90 percent of the remaining principal and interest following a permanent "write-off" of not less than 10 percent of the outstanding loan balance. The amount of debt written off must be sufficient to establish a positive cash flow for the agricultural producer.

The American Bankers Association supports these amendments in principle as they do offer a tool to allow some lenders to continue to provide credit to a number of farmers who do not presently have the ability to repay their loans. However, it is our Association's belief, that inherent administrative obstacles, and more importantly, economic realities will preclude a wide utilization of this program. In addition, lenders with portfolios concentrated in loans to agricultural producers simply will not be able to financially

accomodate the devastating effect on capital that would result from extension of this program to the growing number of borrowers who need relief.

We have taken into consideration and respectfully propose an alternative feature to be added to the debt assistance program. This feature would incorporate a reduction of interest rate in exchange for a 90 percent guarantee. In addition to the sacrificed earnings which will result from a writing down of interest rates, our Association would suggest that banks might be willing to share in the financial burdens of agriculture by partially funding this program through the payment of a one percent fee of the guaranteed amount. Further, to resolve the public lender's lack of confidence regarding collection of FmHA guarantees in the event of default, we believe that procedures must be modified for a more expeditious payment with fewer complicating restrictions.

Our Association proposes that both existing indebtedness and loans for current operating expenses should receive the protection of a guarantee. The interest rate charged on these credits should be adjusted down by an amount which results in a postive cash flow to the customer. However, interest rates should not exceed the corresponding rate charged for similar categories of FmHA direct loans. The rates should be fixed on an annual basis according to the above criteria.

The one percent guarantee fee should differ from but not be in addition to the fee charged on other FmHA loans in that this fee should not be passed on to the individual customer. It is clear that the customer is in no position to pay such a fee. Further, lenders view this fee as compensation for the benefit which will accrue to us if administrative procedures are streamlined.

We propose that during the guarantee period, the customer must adhere to a closely monitored, austere operating program which foregoes all but the most necessary capital expenditures. Also, the customer, lender and other creditors must agree that all proceeds from the customer's operation must go the lender for disposition according to an agreed upon plan. Excess cash flow beyond debt service requirements and basic living needs shall be applied to the principle balance of the outstanding notes. If the borrower's financial condition improves to the point that the guarantee is no longer needed, the lender will notify the government and the guarantee will be cancelled. Lender, customer, and the government are then relieved of their agreements.

While the goal of each individual restructuring package must be the ultimate financial liability of the customer, it is inevitable that some will fail. In order to gain a widespread acceptance of the use

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of FmHA guarantees, the common perception that guarantees are uncollectable, or at best undesirable due to the required complete liquidation of assets prior to any disbursements must be addressed. We believe that procedures for liquidation similar to those offered under Small Business Administration (SBA) guarantee loan programs should be put in place, allowing for early disbursements of guarantee proceeds based on expected liquidation values.

Our support for this program is also subject to one additional caveat. It is clear that the program will only work effectively if it is limited to those borrowers whose finances can be materially improved by a reduction in interest rate. Any regulations finally adopted should make clear that the program is open to borrowers who will have both a positive cash flow and a high prospect for full debt repayment if they are provided this assistance.

Our Association feels that prompt action must be taken to assist those borrowers who have a chance for survival. We believe that the concepts presented here offer a positive alternative that will contribute substantially to the attainment of this goal, while providing for an appropriate and equitable sharing of the losses which are occurring in the agricultural section.

The American Bankers Association appreciates the opportunity the Farmers Home Administration has provided to comment on this Interim Rule.

Sincerely,

Gerald M. Lowrie

Gerald M. Lowrie

FARM CREDIT PROBLEMS AND THEIR IMPACT ON AGRICULTURAL BANKS

WEDNESDAY, FEBRUARY 27, 1985

U.S. SENATE,
SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room SR 428A, Russell Senate Office Building, Hon. Larry Pressler (chairman of the subcommittee) presiding.

Present: Senators Pressler, Bumpers, and Dixon.

Staff present: R. Michael Haynes, chief counsel; Mel Ustod and Tom Hohenthaner, legislative assistants to Senator Pressler; and Dorothy C. Olson, hearing clerk.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA AND CHAIRMAN OF THE SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM

Senator PRESSLER. I will call this hearing to order.

I am going to call on Senator Dixon for a statement, but first of all, let me say that the purpose of this hearing is to look into some of the impacts that the agricultural crisis is having on the small business community, especially in some of our rural cities and towns, but across the Nation. There is a spinoff effect of the agricultural crisis on small town banks and on small town businesses, but also big city banks and businesses are ultimately affected.

We have a number of issues before us in addition to the agricultural crisis, or that are springing from the agricultural crisis. We will focus on the effects of farm problems on rural communities and urban communities, and specifically on farm supply businesses and cooperatives. We have a variety of surveys that we will place in the record. One survey found that gross sales in one town fell 26 percent from 1979 to 1983. This same community has lost approximately 20 percent of its small businesses. The disappearance of these individual farms and small businesses has led to a decline in school enrollment and local tax revenues, a spinoff effect. The amount of property with delinquent taxes in some areas has increased substantially in recent years, and that will affect State and local governments.

All of these unfortunate events are directly related to the reduction in farm income and inability of farmers to purchase goods, and in some cases, their inability to pay for goods previously purchased.

If this trend is not reversed, many business communities will become ghost towns.

The groups hardest hit, apparently, are farm suppliers. In the past many of the fertilizer dealers, seed dealers, and farm cooperatives would provide farmers with the crop inputs that they needed in spring and summer and would not have to be repaid until the fall, when the harvest was in. These lenient policies may be a thing of the past. An estimated 20 percent of my State's small businesses are suffering severe financial distress. In South Dakota and Minnesota since January 1, 1983, 68 implement dealers have closed their doors—68 implement dealers. This represents 34 dealers a year, and the projection for 1985 is that another 50 to 60 dealerships may go out of business. These figures indicate that agribusinesses will have a tough time just staying in business and will not have the foundation necessary to extend much credit to their customers.

I will be including in the hearing record a letter I have received from a farm equipment association of different States.

It is evident that the crisis faced by our farmers and ranchers is not limited to their operations. It affects everyone, and will affect every business in small towns and, eventually, big cities. As we lose our family farmer to foreclosure or forced sellout we weaken and ultimately destroy grocery stores, cafes, hardware stores, as well as farm implement dealers and grain elevators.

I recently surveyed several Main Street businesses in South Dakota to see how the farm problem had affected them. For example, a smalltown grocery store operator observed a marked increase in the number of food stamps he is receiving and a dramatic decline in customers paying by check. A farm supplier predicted that his sales this spring would be off 50 percent, and a trucker who hauls farm supplies and equipment said his business had fallen off 75 percent. Few businesses, no matter how efficiently managed, can survive such a loss of business. The University of South Dakota Research Bureau also keeps track of sales tax receipts; their statistics indicate a much slower growth in sales tax receipts in rural counties, and also a decline in sales tax receipts growth in recent years.

Hopefully, today we will get a better idea of the breadth and severity of the farm crisis impact on rural small businesses. In South Dakota, farmers, small businessmen, and other concerned citizens seem to be cooperating in the search for agricultural survival. This is essential, and rural areas must speak out loudly and clearly with a united voice. I hope today's hearing will further demonstrate the unity of purpose and the severity of rural America's problems. And let me say that we need to build a coalition of businessmen, bankers, farmers, and others in this effort.

I am now going to call on my colleague, Senator Dixon, but I will say that in addition to the witnesses listed we will try to find time to hear from four dairy farmers from South Dakota at the end of the hearing, if they are able to stay, from Delmont, Fedora, Parkston, and Woonsocket, SD, if there is no objection, at the very end of the hearing.

[The prepared statements of Senators Pressler and Boren follow:]

OPENING STATEMENT OF SENATOR LARRY PRESSLER

before the

SENATE SMALL BUSINESS COMMITTEE: FAMILY FARM SUBCOMMITTEE

on

FARM CREDIT PROBLEMS AND THEIR
IMPACT ON SMALL BUSINESS

February 27, 1985

I WANT TO WELCOME EVERYONE HERE TODAY AND THANK THE WITNESSES FOR TAKING THE TIME TO TESTIFY. WE LOOK FORWARD TO HEARING THEIR COMMENTS.

THIS MORNING WE ARE HAVING OUR SECOND HEARING ON THE FARM CRISIS AND ITS IMPACT ON AGRICULTURAL BANKS, SMALL BUSINESSES AND RURAL COMMUNITIES. OUR FIRST HEARING FOCUSED ON THE IMPACT OF THE FARM CRISIS ON AGRICULTURAL LENDERS. THE HEARING ILLUSTRATED THE SEVERE CREDIT PROBLEMS FACING FARMERS AND THE RESULTING DIFFICULTIES EXPERIENCED BY RURAL BANKS. SINCE THAT HEARING, THE SENATE AND THE ADMINISTRATION HAVE TAKEN ACTIONS TO PROVIDE CREDIT ASSISTANCE TO FARMERS.

TODAY WE WILL FOCUS ON THE EFFECTS OF FARM PROBLEMS ON RURAL COMMUNITIES, AND SPECIFICALLY ON FARM SUPPLY BUSINESSES AND COOPERATIVES. MANY SMALL COMMUNITIES IN SOUTH DAKOTA ARE HAVING TROUBLE RESULTING FROM THE LOSS OF FARMERS AND THE CLOSING OF LOCAL BUSINESSES. ONE SURVEY FOUND THAT GROSS SALES OF ONE RURAL TOWN FELL 26 PERCENT FROM 1979 TO 1983. THIS SAME COMMUNITY HAS LOST APPROXIMATELY 20 PERCENT OF ITS SMALL BUSINESSES. THE DISAPPEARANCE OF THESE INDIVIDUAL FARMS AND SMALL BUSINESSES HAS LED TO A DECLINE IN SCHOOL ENROLLMENT AND LOCAL TAX REVENUE. THE AMOUNT OF PROPERTY WITH DELINQUENT TAXES IN

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IN RURAL AREAS HAS INCREASED SUBSTANTIALLY IN RECENT YEARS. ALL OF THESE UNFORTUNATE EVENTS ARE DIRECTLY RELATED TO THE REDUCTION IN FARM INCOME AND INABILITY OF FARMERS TO PURCHASE GOODS, AND IN SOME CASES, THEIR INABILITY TO PAY FOR GOODS PREVIOUSLY PURCHASED. IF THIS TREND IS NOT REVERSED, THEN MANY SMALL RURAL COMMUNITIES WILL BECOME GHOST TOWNS.

THE GROUPS HARDEST HIT ARE, OF COURSE, THE FARM SUPPLIERS. IN THE PAST, MANY OF THE FERTILIZER DEALERS, SEED DEALERS OR FARM COOPERATIVES WOULD PROVIDE FARMERS WITH THE CROP INPUTS THEY NEEDED IN THE SPRING AND THE FARMER WOULD NOT HAVE TO REPAY THE SUPPLIER UNTIL FALL, WHEN HE HARVESTED OR SOLD HIS CROP. THESE LENIENT POLICIES MAY BE A THING OF THE PAST. AN ESTIMATED 20 PERCENT OF SOUTH DAKOTA'S SMALL BUSINESSES ARE SUFFERING SEVERE FINANCIAL DISTRESS. IN SOUTH DAKOTA AND MINNESOTA SINCE JANUARY 1, 1983, 68 IMPLEMENT DEALERSHIPS HAVE CLOSED THEIR DOORS. THIS REPRESENTS 34 DEALERS A YEAR, AND THE PROJECTION FOR 1985 IS THAT ANOTHER 50 TO 60 DEALERSHIPS MAY GO OUT OF BUSINESS. THESE FIGURES INDICATE THAT AGRICULTURAL-RELATED BUSINESSES WILL HAVE A TOUGH TIME JUST STAYING IN BUSINESS AND WILL NOT HAVE THE FOUNDATION NECESSARY TO EXTEND MUCH CREDIT TO THEIR CUSTOMERS. I WILL BE INCLUDING IN THE HEARING RECORD A LETTER I RECEIVED FROM THE FARM EQUIPMENT ASSOCIATION OF MINNESOTA AND SOUTH DAKOTA WHICH ADDRESSES THIS PROBLEM.

IT IS EVIDENT THAT THE CRISIS FACED BY OUR FARMERS AND RANCHERS IS NOT LIMITED TO THEIR OPERATIONS. IT AFFECTS EVERY MAIN STREET BUSINESS IN EVERY RURAL TOWN IN THIS COUNTRY. AS WE LOSE OUR FAMILY FARMER TO FORECLOSURE OR FORCED SELL-OUT, WE WEAKEN AND ULTIMATELY DESTROY GROCERY STORES, CAFES, HARDWARE

STORES, AS WELL AS FARM IMPLEMENT DEALERS AND GRAIN ELEVATORS. I RECENTLY SURVEYED SEVERAL MAIN STREET BUSINESSES IN SOUTH DAKOTA TO SEE HOW THE FARM PROBLEM HAS AFFECTED THEM. FOR EXAMPLE, A SMALL-TOWN GROCERY STORE OPERATOR OBSERVED A MARKED INCREASE IN THE NUMBER OF FOOD STAMPS HE IS RECEIVING AND A DRAMATIC DECLINE IN CUSTOMERS PAYING BY CHECK. A FARM SUPPLIER PREDICTED THAT HIS SALES THIS SPRING WOULD BE OFF FIFTY PERCENT; AND A TRUCKER WHO HAULS FARM SUPPLIES AND EQUIPMENT SAID HIS BUSINESS HAS FALLEN OFF 75 PERCENT. FEW BUSINESSES, NO MATTER HOW EFFICIENTLY MANAGED, CAN SURVIVE SUCH A LOSS OF BUSINESS. THE UNIVERSITY OF SOUTH DAKOTA RESEARCH BUREAU ALSO KEEPS TRACK OF SALES TAX RECEIPTS. THEIR STATISTICS INDICATE A MUCH SLOWER GROWTH IN SALES TAX RECEIPTS IN RURAL COUNTIES AND ALSO A DECLINE IN SALES TAX RECEIPTS GROWTH IN RECENT YEARS.

HOPEFULLY, TODAY WE WILL GET A BETTER IDEA OF THE BREADTH AND SEVERITY OF THE FARM CRISIS IMPACT ON RURAL SMALL BUSINESS. IN SOUTH DAKOTA, FARMERS, SMALL BUSINESSMEN, AND OTHER CONCERNED CITIZENS SEEM TO BE COOPERATING IN THE SEARCH FOR AGRICULTURAL SURVIVAL. THIS IS ESSENTIAL, AND RURAL AREAS MUST SPEAK OUT LOUDLY AND CLEARLY WITH A UNITED VOICE. I HOPE TODAY'S HEARING WILL FURTHER DEMONSTRATE THAT UNITY OF PURPOSE AND THE SEVERITY OF RURAL AMERICA'S PROBLEMS.

FARM EQUIPMENT ASSOCIATION
OF MINNESOTA AND SOUTH DAKOTA

1985 FEB 15 AM 10:46 EAST BROADWAY ● OWATONNA MN 55060 ● PH 507 451 1136

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BOB ELLEFSON
MITCHELL SD

PATRICK ARNOLD
ST CLOUD MN

STEVE NELSON
AKRENA MN

February 1985

To: South Dakota Congressional Delegation

Re: Rural economy and the farm equipment dealer

The continuing deterioration of the economy in rural Minnesota is not only a farm crisis, but also a "main street" crisis. When farmers do not have operating capital, the impact on main street, especially suppliers such as seed, chemical, petroleum and farm equipment companies, is devastating.

Accounts receivables are building and collections are extremely difficult. New farm equipment sales are at an all time low, and used equipment prices are depressed due to the extremely low prices of equipment at the many farm auctions. Also, farmer bankruptcies and forced repossessions add to the dilemma and result in financial losses that many dealers cannot afford.

These special circumstances are directly related to the financial crisis our farmers are suffering and the result is starting to take its toll. Farm Equipment Association records show 68 dealership closings since December 31, 1982. This represents 14 dealers per year with an additional 50 to 60 projected to close in 1985. These figures do not take into account the possible closings of dealerships due to the Tenneco/IH merger.

These dealers are usually the largest employers in their communities with an average of approximately 12 employees. The loss of jobs to these people and their ability to fulfill their financial responsibilities is devastating to the entire community.

The Farm Equipment Association feels it is of the utmost importance that our elected officials totally understand the depth of the problem and the resulting effect it has all the way from main street to the manufacturing companies production lines where thousands of factory workers are presently unemployed.

A long range plan for a sound agricultural economy is essential to rural America. However, in order to avoid an immediate disaster, short term measures must be taken in the form of emergency funding, loans, and interest relief of substantial proportions in order to buy time for the effects of a long range total agriculture program to take hold and bring back a stable apricultural economy.

Best regards,

Bill Ryden

William L. Ryden
Assistant Executive Vice President

WR:t

Statement by Senator David Boren
before the Family Farm Subcommittee
of the Senate Small Business Committee

Mr. Chairman, for some time several Members of the Senate have been talking about the crisis in American agriculture. Regretfully, our words have been unheeded by the administration and by Congress, in general. We now face a critical national emergency in agriculture and still most of the Nation remains unaware of the wave of tragedy that appears ready to cascade across America's heartland. As an article on the front page of the Washington Post Sunday, January 27, 1985, said:

> The great farm shakeout that many have predicted since 1981 appears to be at hand, with no clear sense of how far the ripples of failure will reach into the national economy or of how rural America will be reshaped.

Unfortunately, too many people in this country believe that the health of the agricultural economy does not affect them personally. Yet, history has provided us with a great lesson if we would but consult it. For those who have not seen my statements over the past few years. I will repeat here the lesson that history teaches.

It was the collapse of the agricultural economy, leading to dispersal sales of land and equipment, which signaled the beginning of the Great Depression. At the time, there was a domino effect from the collapse of agriculture which brought

this country virtually to an economic standstill. As more and more farm land was forced on the market, land values and equity for everyone fell drastically. As land values fell, more and more banks were unable to remain in operation. As banks failed, more and more businesses were placed in jeopardy. As should be apparent, Mr. Chairman, a failure in agriculture has a tremendous effect that ripples throughout the economy.

Despite history, there are many who believe that this will not happen again because not as many people are dependent upon agriculture for the main support. However, the economic health of this country as a whole remains very much dependent upon the health of the agricultural sector. Agriculture remains the backbone of this country.

The Nation's biggest industry is agriculture, with farm assets totaling over $1,050 billion and representing approximately 70% of the capital assets of all manufacturing corporations in the United States. Not only is agriculture the biggest industry, it is the Nation's largest employer, with 22 million people working in some phase of agriculture or refinement of agricultural products. Farming, alone, has as many workers as the work forces of transportation, the steel industry, and the automobile industry combined. Approximately 1 out of 5 jobs in private enterprise is

generated directly by agriculture. Agriculture, alone, generates about 20% of the gross national product.

The agricultural sector uses output from more than 80% of the basic industries in the United States. Farmers are the fourth largest customer of the finance and insurance industry and the fourth largest user of real estate and rental services. Farmers annually spend over $10 billion for farm tractors and other motor vehicles, machinery and equipment. This alone provides jobs for about 150,000 employees in the auto industry. Farming also uses more petroleum than any other single industry with annual expenditures for fuel, lubricants, and maintenance for machinery and motor vehicles used in the farm business amounting to $15.4 billion. Each year, farmers purchase $21.4 billion for feed and seed and $9 billion for fertilizer and lime. Farmers use 360 million pounds of rubber each year. Farmers annually purchase 6.5 million tons of steel in the form of farm machinery, trucks, cars, fencing, and building materials. From the use of steel products alone, 40,000 jobs in the steel industry are created by agriculture.

Agricultural exports have a considerable impact upon the economy. In 1984, the overall trade deficit was reduced by the $19 billion in the agricultural account where we had a surplus. For every $1 billion in agricultural exports,

35,000 jobs are created. Each dollar of agricultural export stimulate an additional $1.05 of output in the U.S. economy. About 70% of this additional economic activity accrues to nonfarm sectors of the economy.

Mr. Chairman, agriculture is critically important in our Nation's economy. A thriving agricultural economy means a thriving American economy. A depressed agricultural economy translates into a depressed American economy. For the past few years, several of us have tried to warn Congress and the Administration about the ultimate effects of the agricultural crisis. But even our words were unheeded. Too many thought the problem would just go away, would take care of itself. Regretfully, that is not the way it has worked out. There is, and has been, a crisis in American agriculture for the past 4 years. Today, the crisis has spread to the banking industry, just as it did over 50 years ago. Today, we not only have a crisis in agriculture, we have a crisis in the banking sector as well.

Over the past 5 years, we have seen an increase in farm bankruptcies and forced liquidations of over 200%. During the decade of the seventies, 21% of the farmers in my home State of Oklahoma went out of business. For the same period, the number of farms in Iowa were decreased by 12,000. For

Nebraska, there were 8,000 fewer farms in 1980 than in 1970. So what, some may say. Secretary Block has made the comment that this is not an unusual trend, that it has been happening for the past 50 years. Yes, farm numbers have declined steadily over the past 50 years. However, right now, we are experiencing a time where the number of farmers going out of business in 1 year is equivalent to or greater than the number of farmers that went out of business during the entire decade of the seventies. According to the Washington Post article in the January 27, 1985 paper, it is estimated that 17,000 farmers in Iowa out of a total of 113,000 in that State will be out of business by the end of the next few months. Compare this to the numbers cited above. This tremendous increase in foreclosures, bankruptcies, and liquidations have placed in jeopardy more than 130 Iowa banks according to this article. The Post article also talks about the problems the State of Nebraska is experiencing. It is estimated that 6,300 farmers in that State will go out of business this year, compared to the 8,000 figure for the entire decade of the seventies. Of 40 banks that have failed nationally in the past six months, more than half had large agricultural portfolios.

Mr. Chairman, the situation we are confronting in agriculture constitutes a critical national emergency. This

is not true merely from the standpoint of the farmer, but also from the standpoint of every citizen in this country. I do not believe the American people will allow the impending agricultural collapse to happen if they are aware of the ramifications, if they are aware of the facts. For the past 6 years, I have done everything I have known to provide these facts to the general public. Yet, repeatedly over that time period, I felt as though no one were listening, as though the press in our large cities did not care to report what was happening to the backbone of this Nation. Finally, Mr. Chairman, we are beginning to see some interest in the agricultural crisis. Mr. Chairman, the American people need to be aware that the crisis is threatening the entire structure of rural America and placing in jeopardy the American economy as a whole. I hope that my Senate colleagues will join me as you have. Hopefully, with constant effort and thoughtful reflection, we can arrive at a solution that will put American agriculture back on its feet. Emergency action will not wait. Action on the credit front must be taken now.

Unless the emergency is confronted now, the questions of the long-range solution of the agricultural problem will become moot.

Senator PRESSLER. And now I call on Senator Dixon of Illinois.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Mr. Chairman, let me first say that I regret that I will not be able to stay for the entire hearing due to the fact that there is a very important meeting of the Armed Services Committee going on right now, and a delegation meeting of my Illinois delegation as well on a matter concerning a plant that may come into our State that will occupy some of my time.

But I want to pay tribute to you, Mr. Chairman, because the people in this room and the people in the country know that there is a debate raging in the U.S. Senate right now about what we're going to do about this farm credit problem, both on a short-term and, to some extent, on a long-term basis, that is quite divisive.

You know, I think that the test of a man in public service is whether he is able to stand, sometimes against the crowd, and I want to pay tribute to the chairman who is a cosponsor of my amendment which will be voted on today or sometime very shortly, that would permit an advance in the spring of up to 50 percent of the amount the farmer can obtain in the fall after harvest from ASCS, up to $50,000 a farmer, so they can put their crop in the ground this spring. And the chairman here, along with one or two others—Senator Grassley of Iowa, Senator Andrews of North Dakota—has had the courage to stand up and to speak out and to be counted, and I think that's a great tribute to the Chairman who I know is under some pressure to alter his position, and I know he has indicated to me he will not, and I want to express my appreciation to him and make several points here.

But I want to make these points. First of all, these are unbelievable statistics. This is the U.S. Department of Agriculture statistic: 8.8 percent of the farmers in this country—and you can't take eight-tenths of a farmer, so 9 out of every 100 farmers in the country—right now have a debt-to-asset ratio in excess of 70 percent which makes them "not creditworthy" under any of the plans that have been agreed upon so far in all the dialogue that took place and all of the filibuster that came down over the last week or so. So 9 out of 100 farmers can't put a crop in the ground this spring unless we do something further in the next several days.

That represents 186,000 farms that are sitting on one-third of the $210 billion farm debt in this great Nation of ours. And I just want to tell you one story that happened to me yesterday. It's so impressive to me because a 58-year-old farmer from Moultrie County in Illinois—that's in central eastern Illinois, Mr. Chairman—called me. Moultrie County, IL, is the barometer, politically, in my State. Moultrie County goes as the Nation in every election, and has historically throughout this century.

And this fellow said, "I wonder if they appreciate in Washington the fact that this is more than just a farm problem," something the chairman talked about. He said;

> Here in Moultrie County, in the town nearest me, a lumber yard just closed. Two implement dealers have closed in the last year, and a farm supply store has closed here in Moultrie County.

And that's just a little bitty county. Imagine the economic turmoil in that area as a consequence of these major business houses in that area going under, and this 58-year-old farmer, who has tilled the soil all his lifetime—I have some empathy for him, because he's about my contemporary— says that if he can't get some money to put that crop in the ground this spring, he's going to join that lumber yard and those two implement dealers and that farm supply store. He's going under, too.

Now, I wonder if there is sufficient appreciation, even in the Congress—where I think we're very sensitive to problems back home—of the tremendous human tragedy that is unfolding in rural America? Not just on the farm, but everywhere in rural America. Now, that is what my colleague and friend, the chairman, hopes to be able to begin to look into in this committee hearing this morning, and I know I speak for a great many of our colleagues when we express to him our personal appreciation for that undertaking.

Senator PRESSLER. Well, I thank Senator Dixon.

I think it is important to note that the amendment that we are cosponsoring on the Senate floor does not have a budgetary impact in the sense that it advances, by 3 or 4 months, the loans at which will be at 9.5 percent or 10 percent interest.

Senator DIXON. Actually, right now, 9⅜ percent, Mr. Chairman, is the current rate under that law.

Senator PRESSLER. With that, I will call our first two witnesses, Mr. Robert Meyer of the Farmers and Ranchers Wool Warehouse, Belle Fourche, and Mr. Kenneth Johns, president of the Johns Chemical Co., Inc., Hillsboro, OH, representing the Fertilizer Institute. We will later hear from the National Farm & Power Equipment Dealers and the National Association of Development Organizations.

If the first two witnesses would come forward, we would much appreciate it. We welcome you both here.

Bob Meyer, it's nice to see you again; a good friend, and one of our great citizens of South Dakota. And Kenneth Johns, we welcome you.

Kenneth, maybe I could call on you first, representing the Fertilizer Institute, and you may make your prepared statement.

STATEMENT OF KENNETH JOHNS, PRESIDENT, JOHNS CHEMICAL CO., INC., REPRESENTING THE FERTILIZER INSTITUTE

Mr. JOHNS. Good morning, Senator Pressler. I sincerely appreciate you taking the time from your extremely demanding schedule to hear comments from a small agribusinessman from southwestern Ohio, and I thank the Family Farm Subcommittee members for their opportunity to address the Fertilizer Institute's concerns related to farm credit.

I founded my own company in 1966 and I have been a dry blender and liquid mixer of farm fertilizer for over 18 years. I have sold to farmers, I've attended church with those farmers, I've socialized with them, worked on committee and community projects and experienced every aspect of farming and agribusiness life my entire business career. For the past 9 years I have been a member of the board of directors of the Merchants National Bank in Hillsboro,

OH. This is an independent bank with 31 percent of our loans to farmers, which classifies us as an agricultural bank. In the spring season this percentage will increase to at least 36 percent with additional agricultural loans. The bank is in very good financial condition and was the second bank in Ohio to be classified by FmHA as an "approved lender bank."

I would like to briefly state who I believe is the American family farmer and their role in our American system. The administration and the majority of Congress may believe the American farmer represents only 2 percent of the voting potential; however, I believe they may be ignoring another 20 percent of the U.S. voters who make their living from that very small farm vote.

During the past 4 years the farmer was a victim of disinflation that benefited the large portion of the U.S. voters; consequently, small agribusinessmen such as myself have had our business extremely stressed while we read every day that prosperity abounds throughout the country. In rural America it is not only the agribusiness sector, but other merchants and service businesses that are suffering because the American farmer is in extreme financial trouble. Rural banks are stressed by classified agricultural loans and small business loans because of the plight of the family farm. Board of director and loan committee meetings at the bank I am associated with now last, commonly, 5 hours or more when just a few years ago one-half that time was all that was needed to review the business of the bank. Directors seriously agonize over decisions affecting our farm and our small business customers, and they are our friends.

The family farmer has recently been characterized as a land speculator who overequipped during the 1970's in expectation of large profits. I aggressively disagree with this generalization to satisfy a budget objective. I would like to take these professional Government administrators on a 3-day tour of midwestern agriculture. I believe they have been in concrete buildings surrounded by agreeing staffs and asphalt parking lots so long they no longer realize what is really happening in the agricultural segment of the U.S. industry.

The family farmer was advised, counseled, educated, and trained by our State universities, agriculture extension services, agencies of the Federal Government, and industry, that they could not survive on a farm of 200 or 300 acres. They were told that they should increase their operation to 500 or 600 acres where grain farming could be efficient and survive the future. Our Government told us during the 1970's we must expand to meet world need for food. A large portion of our family farmers and small agricultural businesses met that challenge. Now, we're characterized as land speculators and greedy individuals who looked for big profits and now want Federal subsidies. There is no other industry that will work for the low per-hour income and return on investment that agriculture is happy to receive.

Senator, these family farmers are not land speculators. Some did speculate in land for big profit, but those were made up of doctors, lawyers, businessmen, large corporations, foreign investors, and others. They drove up land prices as they bought and sold farmland. During the last 30 days our bank loan officer and directors

have been receiving operating loan requests for the spring planting season. I would like to cite a couple of actual farm operations, and I could go on for hours with actual cases, and the cash flow dilemma that will result in rejected operating loans for those farms.

In 1970, a local farmer owning a 260-acre farm had a teenage son who wanted to become a farmer, so they planned their farm operation for the future. The son, now 29 years old, owns 330 acres that he purchased over the years 1971 to 1980. He paid from $300 to $1,000 per acre for an average of $700. He improved the land by tiling, adding sod waterways to stop erosion, and added grain drying and storage facilities. His owned land is 80 percent tillable. This year he will cash rent another 330 tillable acres at $70 per acre, for a total grain acreage of 600 acres. He has a computer for production decisions and bookkeeping and wants to be a career farmer. However, this farm operation projects only a little over $5,000 positive cash flow with no allowance for living expense.

The father also has his own grain farm of 660 acres tillable. They operate the farm businesses separately but do share one no-till planter and one combine for harvesting. The father and son have operating credit available with conventional bank credit this year; however, their past 3-year losses, deflation in the agricultural segment, and no hope in site for any positive profit outlook—they have listed all their land except the original 260 acres for sale with a local realtor. They realize no further credit will be available to them for the future. The USDA policy is driving them out of the farming business, and they are efficient and not land speculators as characterized by the administration.

Another farm in our county, financed for operating by our bank with a 90 percent FmHA guarantee in 1984, is proposing to grow 2,805 acres in corn and soybeans. This operation is owned by the father, who is age 55, and his four sons are fully employed on the farm at $12,000 per year per man. The father, last summer, knowing the farm operation was in serious financial condition, returned to former employment at General Electric in Cincinnati at $30,000 annual income. One daughter-in-law handles the accounting of the farm business with the use of a computer; production and recordkeeping are timely and outstanding. Of the 2,800 acres, 1,060 are owned at an original cost of $980 per acre purchased during the 1970's. The balance of the acreage is cash rented and 50/50 share cropped. This farm financial statement has a net worth of zero to a negative $512,000 depending on the value of appraisal were it to be liquidated by forced auction or orderly sale of land and chattels. This farm has a positive cash flow of $17,600 with outside farm income of $30,000 the father earns included. Our bank has approved this operating loan of $345,000 if FmHA will give a 90 percent guarantee as last year.

The four sons are excellent operators, averaging 700 acres per man, which is about as efficient as a family farm can operate. Some say this is too large an operation to be a family farm, but I disagree. It is not a corporation and it is certainly not a tax shelter for a rich man or a corporation, but an honest family struggling in the farming business.

This loan will very likely be rejected by the State FmHA in Ohio with the new guidelines given us the first week of February. The

director now states in writing that a loan secured by crops with a positive cash flow qualifies for only 60 to 70 percent guarantee, rather than the 90 percent guarantee that was available in 1984. Our board of directors believed last summer, when we applied and were granted the classification "approved lender," we could better service the community. But no, FmHA changed the rules in the middle of the game, or in the middle of the crop year.

I could go on and on stating actual examples of farm financial situations from 200-acre livestock operations to the 2,800-acre grain operation. These situations were not made by the farmer, but they are victims of domestic and international situations.

In 50 days it will be planting time in the Midwest. If the farm credit crisis is not addressed and adequate action taken immediately, we will see the credit crisis spread even more to the small business servicing the farmer. In 1983 the USDA acted on the PIK Program that was only a 90-day wonder to keep the farmer in business another year, with no followup to address the long-term problem. Why then are we delaying another 90-day wonder program for farm credit? Do you know what it's like to have an account file bankruptcy and take that loss out of your pocket? I do. I am one of the very fortunate farm supply dealers who had only one bankruptcy for $36,500 in 1984. I can handle that loss, but I cannot survive multiples of those amounts. If the farmer cannot obtain the financing, many will just walk into their farm supplier and order fertilizer, seed, feed, and other supplies and expect the dealer to finance them. This just cannot be done. Banks loan us money to operate our businesses, not the farmers' businesses.

Senators, in closing, we need FmHA 90 percent guaranteed loans available to farms that will cash flow, or nearly so if they make immediate adjustments, and a long-term market-oriented program in 1985 that does get the Federal Government out of the paid acreage reductions and other subsidies. Please take action now before a large percentage of farms go bankrupt and take us small businesses with them.

Thank you.

[The prepared statement of Mr. Johns follows:]

STATEMENT OF KEN JOHNS, PRESIDENT, JOHNS CHEMICAL CO., INC., ON BEHALF OF THE FERTILIZER INSTITUTE

Good morning, Mr. Chairman. On behalf of The Fertilizer Institute (TFI)*, I would like to thank you and the other members of the Family Farm Subcommittee for this opportunity to address the fertilizer industry's concerns related to farm credit.

I'd like to give you just a brief summary of my background, because I think I bring a somewhat unique perspective to this discussion: I graduated 25 years ago from Ohio State University, majoring in agricultural economics. I founded my own company in 1966 and have been a dry blender and liquid mixer of farm fertilizer for over 18 years. I have sold to farmers, attended church, socialized and worked on committee projects with them. I have experienced every aspect of farming and small, agribusiness life my entire career. For the past nine years, I have also been a member of the Board of Directors of The Merchants National Bank in our hometown of Hillsboro, Ohio. This is an independent bank, with 31 percent of our loans made to farmers -- which classifies us as an agricultural bank. The bank is in very good financial standing and was the second bank in Ohio to be classified by Farmers Home Administration (FmHA) as an "approved lender bank." Obviously, we work closely with FmHA.

So, I bring to you the perspective of an agribusinessman, and also that of an agriculture banker.

*TFI is a voluntary, non-profit association, whose members represent approximately 95 percent of the domestic fertilizer production in the United States. TFI's membership includes: producers, manufacturers, traders, retail dealers and distributors of fertilizer materials. Its members are major shippers, receivers, and exporters of fertilizer and fertilizer materials and are a vital link in the nation's agriculture system.

I'm not here to shed tears about farmers who are inefficent managers and producers. I'm here to discuss what is happening to efficient farmers -- those who are professionally managing their operations, but have been caught in an economic landslide. It's these farmers that agribusinesses and banks depend upon for their livelihood -- as do entire rural communities.

It's these farmers that have been misrepresented and misunderstood in the current debate.

Many are in trouble today because they hedged their bets on rising land values -- and perhaps many should pay the price for such a gamble. But, the farmers I speak of were not land speculators; they were counseled during the '70s to expand their operations to meet U.S. and world food needs -- and to maximize efficiency. And, expand they did.

As commodity prices began to slide in an inflationary economy, good business judgment dictated that farmers use their then-valuable land as collateral against future operating loans. It was not considered a gamble, because these farmers were secure in the knowledge that people will always want food -- and the government was telling them that America was the world's open-air supermarket.

Suddenly, the rules of the game changed. Exports were choked off by embargoes and the high value of the dollar abroad; high interest rates rose dramatically; and commodity prices hit bottom.

While our government shouldn't have the responsibility to bail out every farmer who over extended himself, it seems to me that farmers did no less than they were urged and expected to do: produce food, maintain a livelihood, tough it out, and literally save whole communities from extinction. And, I might add, it's also not the responsibility of government to interfere or disrupt farm markets, but it does. Farmers can't be held liable for a situation largely created by government.

As a businessman, I've been forced to become a sort of lender-of-last-resort when farmers need production supplies. Is it fair that I and my counterparts in agribusiness must make the decision to gamble on the future and hope for payment, or to cut off the farmer's opportunity for success? And, again, I'm talking about efficient, productive farmers who make up the social and economic fabric of rural America. You can't treat this as some cold, impersonal decision.

If farmers fail, in significant numbers, the domino effect on agriculture could be catastrophic. The result is morally, economically, and politically unacceptable.

And there's not much time left to head off this situation.

Planting is about 60 days away. That means many farmers and agribusinesses are about 60 days away from filing bankruptcy. An immediate step to salvage what I call good farmers would be to offer government guarantees on farm loans....not a handout, but an indication to ag banks and ag businesses that farmers are important enough to our nation to deserve the full faith and confidence of the U.S. government. We did as much for Chrysler and for New York City -- and both proved worthy of that faith.

For the longer term, however, The Fertilizer Institute is in philosophical agreement with the need to phase down farmer assistance programs, but only in conjunction with an aggressive export market expansion program....one that lives up to the unfulfilled promises of the '70s. If we have learned nothing else from the experience of government farm programs, acreage reduction efforts, and wonder cures like PIK, it should be that supply management isn't working. Marketing -- a concerted effort to enhance trade -- is our only long-term remedy to this boom-and-bust cycle.

The Fertilizer Institute recognized the short-term credit needs of our customer. I was a member of special task force which evaluated the farm credit situation last year for our industry. Because of our recognition of a short-term credit dilemma, the Institute's board of directors passed a resolution on the subject -- but also passed a long-term statement on farm policy, which are both attached to my written statement.

So, let's apply our short-term credit Band-Aid to get us through this spring, but then let's get on with an '85 Farm Bill that eliminates the need for such quick fixes in springtimes yet to come.

Thank you, Mr. Chairman. I'd be pleased to respond to questions from you or other members of the committee.

The Fertilizer Institute
Agricultural Policy Committee's

RECOMMENDED SHORT-TERM LEGISLATIVE AND ADMINISTRATIVE GOALS
THAT ADDRESS THE CURRENT AGRICULTURAL CREDIT SITUATION

Adopted: January 30, 1985

Res. -85. WHEREAS, The Fertilizer Institute approved an Agricultural Credit Policy on November 5, 1984 that supported a businesslike approach by all those involved in agricultural credit and that efforts promoted a long-term, businesslike approach to national agricultural policymaking provide the best hope for improving net farm income and alleviating farm credit concerns; and

WHEREAS, however, TFI recognizes that an effective, long-term agricultural policy -- which is part of TFI's objective in the 1985 Farm Bill -- cannot be enacted by Congress in an atmosphere of economic calamity in the farm sector; therefore be it

RESOLVED that The Fertilizer Institute will support legislative and adminsitrative actions that:

1. Establish a Presidential Task Force to explore comprehensive solutions for effectively managing farm debt and credit requirements;

2. Strengthen the farm debt restructuring initiative which the President announced in September 1984;

3. Allow banks to write down interest rates on farm loans in exchange for Federal guarantees on the principal (current federal regulations permit writing down only the loan principal);

4. Assure that adequate loan guarantees will be provided under the President's initiative to cover commercial bank demand; and

5. Approve the USDA's pending request for additional field personnel and equipment to reduce the Farmers Home Administration's caseload backlog; and be it further

RESOLVED that this resolution will be reviewed by the Board in November 1986.

The Fertilizer Institute
Agricultural Policy Committee's

RECOMMENDED LONG-TERM LEGISLATIVE GOALS FOR INCLUSION IN 1985 AGRICULTURAL LEGISLATION

Adopted: January 30, 1985

Res. -85. WHEREAS, The Fertilizer Institute approved an Agricultural Policy on November 4, 1983, that encourages a more businesslike approach to agricultural policy; a long-term, consistent agricultural policy and timely announcement of programs; flexible loan rates, if continued; strong foreign market expansion programs such as increasing long and short-term credit for developing countries, increasing long-term bilateral trade agreements, exemption of export programs from cargo preference laws, and improvement of infrastructure of importing nations; meeting export subsidies of competitor nations; contract sanctity; and, support of farmland conservation practices and programs; therefore be it

RESOLVED that The Fertilizer Institute will support legislative proposals that:

1. Promote a flexible, market-oriented agricultural policy in combination with a strong demand oriented agricultural export market expansion program;

2. Provide for long-term rather than four year agricultural legislation that will help ease drastic economic and market fluctuations in the farm supply industry;

3. Increase farmer income through fair and expanded trade by:

   - Providing a mechanism to improve U.S. farmers' competitiveness on the world market by overcoming all unfair trade practices;
   - Enhancing the image of the U.S. as a reliable supplier by guaranteeing existing and future grain agreements against embargoes;
   - Expanding funding for export credit guarantees for developing nations; expanding food donation programs and famine relief;
   - Providing bonus agricultural commodities at no cost to foreign buyers who contract for specified quantities of current and future grain needs;

4. Require a Congressionally-mandated agricultural trade impact statement for all legislation or government actions affecting agricultural exports;

5. Exempt new export credit expansion programs from cargo preference laws;

6. Protect fragile lands by supporting "sodbuster" legislation, to improve water quality and reduce non-point source (farmland) run-off; and

7. Support agriculture research as it continues to be vital to the long-term economic competitiveness of U.S. agriculture in the world marketplace; and be it further

RESOLVED that this resolution will be reviewed by the Board in November 1986.

Senator PRESSLER. Thank you very much.

Senator DIXON. Mr. Chairman, could I pursue with Mr. Johns?

I want to thank you for your remarks, which were excellent, and I agree with everything you said, may I say.

I wanted to go through that timeframe with you, because I think the chairman and myself and others from the farm States understand the fact that time constraints are impacting on what we're doing here, and I wonder if other Members of Congress who aren't from the farm States realize what you're trying to tell us here.

You said that in 50 days the farmer has to be putting that crop in. Now, you're from Ohio, and I happen to be from Illinois; we're similar States—I guess southern Illinois may go a little further south than Ohio—I'm trying to look at a map in my mind. But generally speaking the planting season will change some from extreme southern Illinois to extreme northern Illinois because you have, believe it or not, a 600-mile distance between the northern extremes of my State, up by Wisconsin, and the southern part of my State, down below good parts of Kentucky, including way south of Louisville, for example.

But the farmer—we have to pass something that will permit the farmer to—if we pass our amendment, for instance, Mr. Chairman, we have to pass something that will permit the farmer to sign up if he hasn't signed up by March 1. There have to be rules and regulations issued by the Secretary of Agriculture. That farmer has to obtain his money. He has to go and buy his seed and his fertilizer and I guess his fuel, and there are just a lot of other things.

But given all that, I wonder if you could tell me by what time there has to be a law to be of service to that farmer here? In other words, if we can pass something in the Senate that's passed in the House and goes to the President's desk, by what time do you believe there has to be something on the books in order for that farmer, who now can't get a loan, to get a crop in the ground this spring?

Mr. JOHNS. OK. I'm assuming a planting time of approximately April 20 to start, maybe April 15 to 20 and on into May. I would say that at the very latest it would be the 10th or 15th of March.

Senator DIXON. Well, that's what I have said, that by the middle of March you run up against the wall. If you don't do it by the

middle of March you might as well forget about it, then whatever we've done so far is all that's going to be done. Would you say that's essentially true?

Mr. JOHNS. That's exactly right, Senator Dixon.

Senator PRESSLER. And this advance of payments would be very important in terms of financing that sort of thing, wouldn't it?

Mr. JOHNS. You're talking about the advance payment on the CCC loans?

Senator PRESSLER. Yes.

Mr. JOHNS. This would have an effect, but this is only a portion of the total need. This farmer that is in trouble could finance possibly one-half, one-third, whatever the number is, of his operating money—that is not adequate. That only gets him halfway farming. You can't run a fertilizer business or a farming business with one-half of a line of credit. We need to get the whole farm financed. That's why I'm pushing for 90 percent FmHA guaranteed loans because—your amendment may very well work, but we've got to get this whole farm in operation.

Senator PRESSLER. We will hear from Bob Meyer, and I have some more questions for both of you.

STATEMENT OF ROBERT H. MEYER, CENTER OF THE NATION WOOL WAREHOUSE, BELLE FOURCHE, SD

Mr. MEYER. Thank you, Mr. Chairman, for inviting me to testify. It's an honor in my behalf.

I would like to start by saying that the area of the Midwest that I come from is primarily a range area. My constituents are involved in the livestock business and the production of the cow-calf operation and sheep, lamb, and wool.

The impact of a depressed farm and ranch-related economy is forcing many rural businesses into a near state of panic and business depression. The reduced purchasing power of the farm and ranch people has become very evident in practically all of the small towns in the tristate area of South Dakota, Wyoming, and Montana.

A good example of this is present this very moment in the once-thriving communities of Sturgis and Belle Fourche. These two rural communities have seen over 12 business failures during the past year. And I might explain that Sturgis has a total of 30 businesses on its main street; 9 of those businesses have closed in the past 12 months. Their main streets have many empty buildings, and the remaining businesses are holding on a day-to-day basis. These communities, with populations of less than 5,000 people, are normally the busiest towns in the region.

For several years, property valuations of the rural school districts have decreased in dollar value. The demise in the agriculture economy has led to a decline of small businesses which has seriously curtailed the taxing ability of these school districts, resulting in many cuts in worthwhile school programs.

The answer to all of this is becoming very evident. If the agriculture sector cannot become profitable very soon, many small midwestern communities of today will become the ghost towns of tomorrow.

The present administration's "free market" approach will only consolidate American farming. Consolidation not only means fewer farms, but fewer smalltown merchants and suppliers to those farmers. For example, a large scale corporate farm ultimately bypasses the local grain elevator operator by storing its own and dealing directly with the large terminals. The small rural independent bankers suffer since they aren't as sophisticated and large enough to meet the corporate needs.

Opening agriculture to competitive forces of the free market will ultimately result in not only fewer small farms but fewer small banks, fewer small elevators, fewer rural merchants, and ultimately, fewer small towns.

Small farms and rural communities must be preserved. They have contributed greatly to our strength and well-being by providing America with the best, most plentiful, and cheapest food supply modern civilization has ever known.

I, myself, am a wool merchant located in the heart of America's sheep industry in Belle Fourche, SD. I am very concerned about the lobbying efforts by Australian and New Zealand lobbyists in regard to the 1985 farm bill. I have a copy of a news release that was released last week in Australia, stating that one of their lobbyists was going to be in the United States in early March 1985, to lobby on the U.S. farm bill.

[Material follows:]

[From Stock and Land, Feb. 21, 1985]

UNITED STATES ALLAYS FEARS

(By Robert Honeybun)

United States officials have played down suggestions that the U.S. would use trade action to punish Australia and New Zealand for their stances on military and disarmament issues.

Earlier this week a senior Republican Congressman proposed legislation which would impose restrictions on Australian and NZ exports to the U.S. in retaliation for the NZ nuclear ships policy and Australia's withdrawal of support facilities for monitoring tests of the MX missile.

Mr. Richard Cheney was reported as saying his constituents were expected to live near missiles which helped protect Australia and New Zealand yet had to put up with "damaging" imports from the ANZUS partners.

Mr. Cheney, a congressman from Wyoming, was White House chief of staff for President Ford and is apparently regarded by some in Washington as a rising star in the Republican Party.

Australian, New Zealand and U.S. officials in Canberra portrayed Mr. Cheney's views as those of a farm-state Congressman involved in early lobbying for the 1985 Farm Bill.

The U.S. Agricultural Attache in Canberra, Dale Douglas, said the Reagan administration was not proposing any trade action against the ANZUS countries.

"I can't recall a case where the U.S. has stopped imports to punish somebody unless you go back to the Cuban embargo days," Mr. Douglas said.

"Individual congressmen, for reasons best known to themselves, are making this fuss, not the administration.

"I would think it's dead before it started," he said of Mr. Cheney's proposal, which must survive debate in Congress and Senate and pass the President before it could become law.

With the Reagan administration pushing for a new round of multi-lateral trade negotiations, it is thought that protectionist measures such as that proposed by Mr. Cheney, have little hope of official backing.

The threats to take action against ANZUS partners will be raised by Federal Primary Industry Minister John Kerin when he visits Washington early in March.

Mr. Kerin will be putting Australia's case during early lobbying on the 1958 U.S. Farm Bill.

The Reagan Administration wants to cut government spending on agriculture by 15 percent, or $US6.6 billion, but faces stiff opposition from congressmen from depressed farm states.

Although there have been suggestions that the U.S. could also punish New Zealand by dumping dairy products in NZ export markets, it is believed New Zealand has no complaints with recent U.S. behavior in this area.

Australian and New Zealand officials refused to make any official comment on the trade threats made by Mr. Cheney.

The Australian and Meat Livestock's New York office and attorneys said it was monitoring the situation.

Mr. MEYER. My question is this: Do U.S. citizens lobby the Governments of these two countries regarding their farm programs?

Another concern in my region is the inflation level. Real inflation has not lowered at the farm and ranch level as the national figures indicate. Also, real interest rates, although lower, are no way near the level the farm ranch industry can sustain. Bear in mind, the increased fuel costs, soaring interest rates, coupled with the Government's past embargoes on beef and grain, the lax enforcement on import quotas on meat—all these have helped weaken the market structure. Consequently, agriculture products fell far below levels that should have occurred in the past recessionary periods.

The continuation of the National Wool Act in its present form, which is a self-supporting program sustained by imported wool tariff revenues, is paramount to the survival of the domestic sheep industry in our area. This industry utilizes thousands of acres of arid and desolate land, and creates many dollars from renewable resources and supports hundreds of rural communities like no other industry can—all this from land that would not generate any revenue otherwise.

During the 30-year life of the National Wool Act the sheep producers have set aside voluntarily over $74 million to help build their industry. Accordingly, they have reduced their paychecks by that amount, doing this in a series of referendums that have averaged an 80-percent "yes" vote in the life of the wool program.

This $74 million amounts to $1.32 for every lamb marketed in the United States. Compare this to a checkoff on cattle that averages about 50 cents per head nationwide. Keep in mind that 50 cents on cattle is on an animal that is worth 10 times what a lamb is. This speaks very well about an industry that is attempting to compete with subsidized foreign imports. During the past year, promotion of lamb has begun to pay off. We saw 17 straight weeks of continuing lamb prices at higher levels. This all points to the intended goal of the National Wool Act.

We admit to the decline of the sheep industry over the last 30 years; however, we have had severe predator problems, resulting from Government policies, severe spring snowstorms, and long droughts in our major sheep-producing areas.

Undoubtedly, a viable sheep industry cannot be rebuilt on the Wool Act alone, but it does need to be one of the components. To lose the National Wool Act at the present time would virtually wipe the sheep industry out.

A recent study on the cost returns on a typical sheep operation of 4,000 sheep indicates that the wool incentive payments received

for wool equalled about 20 percent of the gross income of the producers. If this income was discontinued, lamb prices would have to rise 32 percent to compensate; and, given today's market, such an increase is unrealistic. Consequently, more sheep producers would be forced out of business. The sheep industry has operated at a loss the last 3 years and has accumulated a threatening debt load.

Wool and lamb are unique commodities in that we are net importers of those products. We consume more than we produce. The continual strength of the U.S. dollar consequently affects these commodities more than others.

Imports of wool and lamb distort and lower the prices received by our domestic producers, a situation which is dramatically being reflected at this very moment.

The National Wool Act, in effect, corrects this situation to domestic producers.

In addition, in a recent edition of The Wool Record, a Bradford, England publication, Prime Minister Margaret Thatcher contributed an editorial on the virtues of wool, relating the devastating effects their troops encountered from burning uniforms composed of synthetic fibers during fires aboard the troopships participating in the Falklands War with Argentina. America should take heed, recognizing England's misfortune, and preserve our domestic sheep and wool industry as one vital to the national defense. Our National Wool Act recognizes that America cannot be solely dependent on foreign wool suppliers. Therefore, elimination or cutting back of the National Wool Act would not only be devastating to the U.S. sheep industry, but to our national security as well.

Ultimately, if the sheep industry lost the National Wool Act, many rural communities would suffer greatly. Also, assuming the domestic wool market could not make up the income difference, a 32-percent increase in lamb prices would be necessary to sustain our industry. This would immediately be reflected in increased costs to the consumer. The present $2.20 leg of lamb would need to sell at $3.30, resulting in a significant impact on the consumer's grocery dollar.

[The prepared statement of Mr. Meyer follows:]

STATEMENT OF ROBERT H. MEYER, CENTER OF THE NATION WOOL WAREHOUSE, BELL FOURCHE, SD

RURAL AMERICA AND SMALL BUSINESS

THE IMPACT OF A DEPRESSED FARM AND RANCH-RELATED ECONOMY IS FORCING MANY RURAL BUSINESSES INTO A NEAR STATE OF PANIC AND BUSINESS DEPRESSION.

THE REDUCED PURCHASING POWER OF THE FARM AND RANCH PEOPLE HAS BECOME VERY EVIDENT IN PRACTICALLY ALL OF THE SMALL TOWNS IN THE TRI-STATE AREA OF SOUTH DAKOTA, WYOMING AND MONTANA.

A GOOD EXAMPLE OF THIS IS PRESENT THIS VERY MOMENT IN THE ONCE THRIVING COMMUNITIES OF STURGIS AND BELLE FOURCHE, SOUTH DAKOTA. THESE TWO RURAL COMMUNITIES HAVE SEEN OVER 12 BUSINESS FAILURES DURING THE PAST YEAR. THEIR MAIN STREETS HAVE MANY EMPTY BUILDINGS, AND THE REMAINING BUSINESSES ARE HOLDING ON A DAY-TO-DAY BASIS. THESE COMMUNITIES, WITH POPULATIONS OF LESS THAN 5,000, ARE NORMALLY THE BUSIEST TOWNS IN THE REGION.

FOR SEVERAL YEARS PROPERTY VALUATIONS OF RURAL SCHOOL DISTRICTS HAVE DECREASED IN DOLLAR VALUE. THE DEMISE IN THE AGRICULTURE ECONOMY HAS LED TO A DECLINE OF SMALL BUSINESSES WHICH HAS SERIOUSLY CURTAILED THE TAXING ABILITY OF THESE SCHOOL DISTRICTS RESULTING IN MANY CUTS IN WORTHWHILE SCHOOL PROGRAMS.

THE ANSWER TO ALL THIS IS BECOMING VERY EVIDENT. IF THE AGRICULTURE SECTOR CANNOT BECOME PROFITABLE VERY SOON MANY SMALL MIDWESTERN COMMUNITIES OF TODAY WILL BECOME THE GHOST TOWNS OF TOMORROW.

THE PRESENT ADMINISTRATION'S "FREE MARKET" APPROACH WILL ONLY CONSOLIDATE AMERICAN FARMING. CONSOLIDATION NOT ONLY MEANS FEWER FARMERS, BUT FEWER LOCAL SMALL-TOWN MERCHANTS AND SUPPLIERS TO THOSE FARMERS. FOR EXAMPLE, LARGE SCALE CORPORATE FARMS ULTIMATELY BYPASS LOCAL GRAIN ELEVATOR OPERATORS BY STORING THEIR OWN AND DEALING DIRECTLY WITH LARGE TERMINALS; SMALL RURAL INDEPENDENT BANKS SUFFER SINCE THEY AREN'T AS SOPHISTICATED AND LARGE ENOUGH TO MEET LARGE CORPORATE NEEDS.

OPENING AGRICULTURE TO COMPETITIVE FORCES OF THE "FREE MARKET" WILL ULTIMATELY RESULT IN NOT ONLY FEWER SMALL FARMS BUT FEWER SMALL BANKS, FEWER SMALL ELEVATORS, FEWER RURAL MERCHANTS, AND ULTIMATELY FEWER SMALL TOWNS.

SMALL FARMS AND RURAL COMMUNITIES MUST BE PRESERVED. THEY HAVE CONTRIBUTED GREATLY TO OUR STRENGTH AND WELL-BEING BY PROVIDING AMERICA WITH THE BEST, MOST PLENTIFUL, AND CHEAPEST FOOD SUPPLY MODERN CIVILIZATION HAS EVER KNOWN.

I AM A WOOL MERCHANT LOCATED IN THE HEART OF AMERICA'S SHEEP INDUSTRY IN BELLE FOURCHE, SOUTH DAKOTA.

I AM VERY CONCERNED ABOUT THE LOBBYING EFFORTS BY AUSTRALIAN AND NEW ZEALAND LOBBIESTS IN REGARD TO OUR 1985 FARM BILL (AUSTRALIAN NEWS RELEASE DATED 2/21/85). MY QUESTION IS, DO UNITED STATES CITIZENS LOBBY THE GOVERNMENTS OF THESE TWO COUNTRIES REGARDING THEIR FARM PROGRAMS?

ANOTHER CONCERN IN MY REGION IS THE INFLATION LEVEL. REAL INFLATION HAS NOT LOWERED AT THE FARM AND RANCH LEVEL AS THE NATIONAL FIGURES INDICATE. ALSO, REAL INTEREST RATES, ALTHOUGH LOWER, ARE NO WAY NEAR THE LEVEL THE FARM RANCH INDUSTRY CAN SUSTAIN. BEAR IN MIND, THE INCREASED FUEL COSTS, SOARING INTEREST RATES, COUPLED WITH THE GOVERNMENT'S PAST EMBARGOS ON BEEF AND GRAIN, THE LAX ENFORCEMENT ON IMPORT QUOTAS ON MEAT, ALL THESE HAVE HELPED WEAKEN THE MARKET STRUCTURE. CONSEQUENTLY, AGRICULTURE PRODUCTS FELL FAR BELOW LEVELS THAT SHOULD HAVE OCCURRED IN THE PAST RECESSIONARY PERIODS.

THE CONTINUATION OF THE NATIONAL WOOL ACT IN ITS PRESENT FORM, WHICH IS A SELF SUPPORTING PROGRAM SUSTAINED BY IMPORTED WOOL TARIFF REVENUES, IS PARAMOUNT TO THE SURVIVAL OF THE DOMESTIC SHEEP INDUSTRY. THIS INDUSTRY UTILIZES THOUSANDS OF ACRES OF ARID AND DESOLATE LAND, AND CREATES MANY DOLLARS FROM RENEWABLE RESOURCES, AND SUPPORTS HUNDREDS OF RURAL COMMUNITIES LIKE NO OTHER INDUSTRY CAN! ALL THIS, FROM LAND THAT WOULD NOT GENERATE ANY REVENUE OTHERWISE!

DURING THE 30 YEAR LIFE OF THE NATIONAL WOOL ACT THE SHEEP PRODUCERS HAVE SET ASIDE VOLUNTARILY OVER 74 MILLION DOLLARS TO HELP BUILD THEIR INDUSTRY. ACCORDINGLY, THEY HAVE REDUCED THEIR PAY CHECKS BY THAT AMOUNT. DOING THIS IN A SERIES OF REFERENDUMS THAT HAVE AVERAGED A 80 PER CENT PLUS "YES VOTE" IN THE LIFE OF THE WOOL PROGRAM.

THIS 74 MILLION DOLLARS AMOUNTS TO $1.32 FOR EVERY LAMB MARKETED IN THE UNITED STATES. COMPARE THIS TO A CHECK-OFF ON CATTLE THAT AVERAGES ABOUT 50 CENTS PER HEAD NATION WIDE! KEEP IN MIND, THAT 50 CENTS ON CATTLE IS ON AN ANIMAL THAT IS WORTH ABOUT TEN TIMES WHAT A LAMB IS. THIS SPEAKS VERY WELL ABOUT AN INDUSTRY THAT IS ATTEMPTING TO COMPETE WITH SUBSIDIZED FOREIGN IMPORTS. DURING THIS PAST YEAR, PROMOTION OF LAMB HAS BEGUN TO PAY OFF. WE SAW 17 STRAIGHT WEEKS OF CONTINUING LAMB PRICES AT HIGHER LEVELS, THIS ALL POINTS TO THE INTENDED GOAL OF THE NATIONAL WOOL ACT.

WE ADMIT TO THE DECLINE OF THE SHEEP INDUSTRY OVER THE LAST 30 YEARS, HOWEVER, WE HAVE HAD SEVERE PREDATOR PROBLEMS, RESULTING FROM GOVERNMENT POLICIES, SEVERE SPRING SNOW STORMS, AND LONG DROUGHTS IN OUR MAJOR SHEEP PRODUCING AREAS.

UNDOUBTEDLY A VIABLE SHEEP INDUSTRY CANNOT BE REBUILT ON THE WOOL ACT ALONE, BUT IT DOES NEED TO BE ONE OF THE COMPONENTS. TO LOSE THE NATIONAL WOOL ACT AT THE PRESENT TIME WOULD VIRTUALLY WIPE US OUT.

A RECENT STUDY ON COST RETURNS ON A TYPICAL SHEEP OPERATION OF 4,000 SHEEP INDICATES THAT WOOL INCENTIVE PAYMENTS RECEIVED FOR WOOL EQUALLED ABOUT 20 PER CENT OF THE GROSS INCOME OF PRODUCERS. IF THIS INCOME WERE DISCONTINUED, LAMB PRICES WOULD HAVE TO RISE 32 PER CENT TO COMPENSATE, AND, GIVEN TODAY'S MARKET, SUCH AN INCREASE IS UNREALISTIC. CONSEQUENTLY, MORE SHEEP PRODUCERS WOULD BE FORCED OUT OF BUSINESS. THE SHEEP INDUSTRY HAS OPERATED AT A LOSS THE LAST THREE YEARS AND HAS ACCUMULATED A THREATENING DEBT LOAD.

WOOL AND LAMB ARE UNIQUE COMMODITIES IN THAT WE ARE NET IMPORTERS OF THOSE

PRODUCTS. (WE CONSUME MORE THAN WE PRODUCE). THE CONTINUAL STRENGTH OF THE US DOLLAR CONSEQUENTLY AFFECTS THESE COMMODITIES MORE THAN OTHERS.

IMPORTS OF WOOL AND LAMB DISTORT AND LOWER PRICES RECEIVED BY OUR DOMESTIC PRODUCERS, A SITUATION WHICH IS DRAMATICALLY BEING REFLECTED AT THIS VERY MOMENT.

THE PRESENT NATIONAL WOOL ACT, IN EFFECT CORRECTS THIS SITUATION TO DOMESTIC PRODUCERS.

IN ADDITION, IN A RECENT EDITION OF THE WOOL RECORD, A BRADFROD, ENGLAND PUBLICATION, PRIME MINISTER MARGARET THATCHER CONTRIBUTED AN EDITORIAL ON THE VIRTUES OF WOOL, RELATING THE DEVASTATING EFFECTS THEIR TROOPS ENCOUNTERED FROM BURNING UNIFORMS COMPOSED OF SYNTHETIC FIBERS DURING FIRES ABOARD THEIR TROOP SHIPS PARTICIPATING IN THE FALKLANDS WAR WITH ARGENTINA. AMERICA SHOULD TAKE HEED, RECOGNIZING ENGLAND'S MISFORTUNE, AND PRESERVE OUR DOMESTIC SHEEP AND WOOL INDUSTRY, AS ONE VITAL TO OUR NATIONAL DEFENSE. OUR NATIONAL WOOL ACT RECOGNIZES THAT AMERICA CAN NOT BE SOLELY DEPENDENT ON FOREIGN WOOL SUPPLIERS. THEREFORE, ELIMINATION OR CUTTING BACK OF THE NATIONAL WOOL ACT WOULD NOT ONLY BE DEVASTATING TO THE UNITED STATES SHEEP INDUSTRY BUT TO OUR NATIONAL SECURITY AS WELL.

ULTIMATELY, IF THE SHEEP INDUSTRY LOST THE NATIONAL WOOL ACT, MANY RURAL COMMUNITIES WOULD SUFFER GREATLY. ALSO, ASSUMING THE DOMESTIC WOOL MARKET COULD NOT MAKE UP THE INCOME DIFFERENCE, A 32 PER CENT INCREASE IN LAMB PRICES WOULD BE NECESSARY TO SUSTAIN OUR INDUSTRY. THIS WOULD IMMEDIATELY BE REFLECTED IN INCREASE COSTS TO THE CONSUMER: THE PRESENT $2.20 LEG OF LAMB WOULD NEED TO SELL AT $3.30, RESULTING IN A SIGNIFICANT IMPACT ON THE CONSUMERS GROCERY DOLLAR.

THANK YOU FOR THIS OPPORTUNITY TO PRESENT MY VIEWS. I WOULD LIKE TO SUBMIT FOR THE RECORD A BOOKLET THAT OUTLINES THE NECESSITY AND IMPORTANCE OF THE WOOL ACT IN MORE DETAIL.

Mr. MEYER. Thank you for this opportunity to present my views. I would like to submit for the record a booklet that outlines the necessity and importance of the Wool Act in more detail. Thank you very much.

[Material follows:]

The NATIONAL WOOL ACT

Analysis • Review • Renewal

1985

National Wool Growers Association

CONGRESSIONAL RENEWAL
OF THE
WOOL ACT

A National Priority

44-600 O - 85 - 6

Dear Congressmen and Senators:

The coming days will be critical to the 125,000 men and women who raise sheep as a livelihood in America — critical because you and your colleagues must decide at what level to renew the Wool Act.

The following pages outline in some detail the importance of the wool and mohair program to U.S. producers, why it was started, how it is run, and the many features that make it the most unique and most cost-effective of all farm programs.

To summarize briefly:

★ Incentive payments to producers, made under the authority of the Wool Act, are underwritten by tariffs assessed on specified classes of raw wools and some wool fabrics. In keeping with the original intent of the legislation, when enacted in 1954, the payments are not a drain on the federal treasury, rather they transfer tariff collections to wool growers as compensation for lost markets due to high levels of subsidized imports.

★ The continued production of domestic wool is essential to the U.S. Armed Forces. That is what the Wool Act said in 1954, and in every extension-year since. That is what the Chairman of the Senate Armed Services Committee said in 1983 and what the Air Force Chief of Clothing said in 1984. In the Falkland Islands, the British learned of the critical importance of wool when burning polyester melted against skin, and soldiers on the ground were frostbitten because of inadequate, synthetic clothing.

★ We agree with the U.S. Department of Agriculture that the Wool Act is an essential part of the economic structure of the sheep industry, and has a distinct impact on the profit and loss statement of most sheep operations. There is a resurgent interest in raising sheep as a supplemental income source for small agricultural operations. The incentive program is a stimulant to the growing number of people in the U.S. who raise small bands of sheep, and thus contribute to the overall strategic supply of wool and help supply the expanding market for lamb.

★ Wool is one of only a few commodities produced in short supply in the U.S. As such, it is a commodity adversely affected by subsidized imports.

★ The Wool Act was passed in 1954 because the President refused the recommendation of the U.S. Tariff Commission to raise the tariff on wool by ten cents per pound. Then, as now, the Administration was concerned with the effect of increased tariffs on our foreign relations. Instead, the President advanced a novel plan: Don't raise the tariffs, which will raise prices at home and the hair of our friends abroad, *but* let the tariffs *that are* collected go to help the domestic industry which is harmed by those imports.

★ The mohair program, embodied in the Wool Act, provides payments to mohair producers according to a pre-determined formula like the wool incentive payments. Most of the mohair raised in the U.S. comes from Texas. The initiation of the wool and mohair program was critical to the maintenance of the mohair industry in the U.S.

★ Since 1954, $3.6 billion has been collected on wool tariffs. $1.4 billion has been paid to wool producers and the balance of collections, $2.2 billion, has gone to the General Treasury. In the absence of the Wool Act, which makes necessary the continuation of the tariffs, how long does one suppose it would take the State Department to eliminate those tariffs? Even with the Wool Act, wool tariffs have been reduced 71% since 1947, not even accounting for inflation. Thus, it can be reasonably argued that the existence and continuation of the Wool Act actually makes money for the U.S. government. While the tariff collections have been substantially reduced, they help to offset the subsidies received by foreign sheep producers — subsidies that give them a distinct advantage over the domestic grower.

★ The Wool Act contains a unique "self-help" provision. Under Section 708, the U.S. sheep industry has organized an advertising and promotion program funded by the producers. Assessments are withheld from the incentive payments, and placed into the market development program administered by sheep growers, under agreement with the U.S. Department of Agriculture. No other commodity boasts this unique arrangement, and the sheepmen themselves have voted to continue and increase the assessment through referendums with every extension of the Wool Act.

The Wool Act is a good program, and a unique program. Unlike other commodity programs, it doesn't create unmanageable surplus storage problems. It aids the small business structure of rural America without reaching into the taxpayers' pocket. Financed prudently, it helps thousands of hard-working people who want to stay on the land, and it is critical in times of national conflict.

Please read the enclosed information, and please fight to help us renew the Wool Act so that our great industry can survive.

Sincerely,

The American Sheepmen and Women

NATIONAL WOOL GROWERS ASSOCIATION

Arizona Wool Producers Association
4320 E. Broadway, Phoenix 85040
California Wool Growers Association
3382 El Camino Ave., Sacramento 95821
Colorado Wool Growers Association
211 Livestock Exchange Bldg., Denver 80216
Empire State Sheep Producers Cooperative
RD 2, Box 99B, Waterville, NY 13480
Idaho Wool Growers Association
P.O. Box 2596, Boise 83701
Illinois Lamb & Wool Producers, Inc.
Knoxville 61448
Indiana Sheep Breeders Association
Department of Animal Sciences,
Purdue University, Lafayette 47907
Iowa Sheep Producers Association
Iowa Farm Bureau Building
5400 University Ave., Des Moines 50266
Kansas Sheep Association
Kansas State University, Manhattan 66506
Kentucky Sheep & Wool Producers Association
R.R. 2, Box 396, Danville 40422
Michigan Sheep Breeders Association
205 Anthony Hall, Michigan State Univ.,
East Lansing 48823
Minnesota Lamb & Wool Producers
Route 1, Box 11, Elgin 55932
Missouri Sheep Producers Association
914 N. Kentucky, Mexico 65265
Montana Wool Growers Association
P.O. Box 1693, Helena 59624
Nebraska Sheep Council
211 MBH, University of Nebraska
Lincoln 68583
Nevada Wool Growers Association
1100 East 15th St., Ely 89301
New Mexico Wool Growers, Inc.
Box 220, Roswell 88201
North Central Wool Growers Association
101 Twenty-Seventh Ave., S.E.,
Minneapolis, Minnesota 55414
North Dakota Lamb & Wool Producers
Fullerton 58441
Ohio Sheep Improvement Association
2029 Fyffe Road, Columbus 43210
Oklahoma Sheep & Wool Producers, Inc.
Oklahoma State Univ., Stillwater 74074
Oregon Sheep Growers Association
Red Lion Lloyd Center Hotel,
1000 N.E. Multnomah St., Portland 97232
Pennsylvania Cooperative Sheep & Wool Growers Association
RD 1, Box 145, Union Dale 18470
South Dakota Sheep Growers Association
P.O. Box 506, Marion 57043
Texas Sheep and Goat Raisers' Association
P.O. Box 2290, San Angelo 76902
Utah Wool Growers Association
8 East Broadway, Suite 415,
Salt Lake City 84111
Vermont Sheep Breeders Association
Brookside Farm, Tunbridge 05077
Virginia Sheep Federation
Blacksburg 23824
Washington Wool Growers Association
Rt. 1, Box 256,Goldendale 98620
Wyoming Wool Growers Association
P.O. Box 115, Casper 82601

ASSOCIATE MEMBERS
American Corriedale Sheep Association
18106 Woodgate Rd., Montrose, Colo. 81401
American Hampshire Sheep Association
P.O. Box 345, Ashland, Missouri 65010
Burlington Industries Wool Co.
P.O. Box 788, Clarksville, Virginia 23927
Columbia Sheep Breeders' Association of America
P.O. Box 272, State Route 182 East,
Upper Sandusky, Ohio 43351
Mid-States Wool Growers Cooperative Association
3900 Groves Rd., Columbus, Ohio 43227
National Suffolk Sheep Association
P.O. Box 324, Columbia, Missouri 65201
Prouvost, Lefebvre & Co., Inc.
P.O. Box 97, Jamestown, S.C. 29453
R. C. Elliott & Company
P.O. Box 25853, Salt Lake City, Utah 84125

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THE WOOL ACT

It may not have been the most dramatic moment in American agricultural history, but in 1954 Congress and the Administration wrote the most unique farm program ever devised. It was unique because it addressed so many problems, successfully, in one piece of legislation.

The Wool Act helped ranchers and farmers who found themselves virtually inundated by subsidized, low-cost wool imports.

The Wool Act, which created the wool and mohair programs, provided wool and mohair growers financial assistance and price stability without asking or requiring the American taxpayer to foot the bill.

The Wool Act ensured that the U.S. military would have a domestic supply of wool in time of conflict, and that the U.S. textile industry would continue to have a vital source of wool.

The Wool Act kept the wool and mohair industry alive, and kept thousands and thousands of farmers and ranchers where they wanted to be: on the land. It enabled these farmers and ranchers to utilize marginal lands that were otherwise unsuitable for agriculture. It sustained rural economies and helped to keep America's small communities alive and vibrant.

It was February 19, 1954, and the Senate Agriculture Committee had convened to consider S.2911, the National Wool Bill. In 1953, the U.S. Tariff Commission was called on to report to the President their recommendations on what to do to assist this troubled industry. President Eisenhower also asked the Department of Agriculture for a similar report.

Here was the problem: In 1942, the Office of Price Administration froze the price of wool at 41 cents per pound because of the wartime, urgent need for wool. As sheepmen could not even come close to staying in business at this price, by 1946 the number of sheep in the U.S. had gone from 49,346,000 head to 31,805,000, a reduction of 36%. To make matters even worse the tariffs on wool were reduced by 25%, inviting an avalanche of low-priced, subsidized imports. As proof of the calamity caused by the OPA price freeze and the lower tariffs, consider this: From 1943 to 1953, the production of sugar in the U.S. increased 13%. Wheat increased 25%. Tobacco increased 62%. Soybeans increased 72%. Rice increased 80%. Cotton increased 34%. Corn increased 7%. *Wool production decreased 42%.*

The Tariff Commission and USDA reported to the President: Tariffs are too low on wool, and the industry is being severely harmed. Raise the tariffs by 10 cents per pound and by as much as 50% of ad valorem.

The President refused the Tariff Commission recommendation because he did not want to ire our international trading partners nor raise the price of consumer goods. Instead, he proposed a price support program that would use portions of the tariff money collected on wool as payments to U.S. producers when the price they received for their wool did not reach a reasonable level (as determined by USDA).

At the February 19, 1954 hearings, ASSISTANT USDA SECRETARY ROSS RIZLEY explained the President's plan.

MR. RIZLEY: We may as well recognize that our country has reached a point in international affairs and our domestic economy where the best solution is to apply the protective tariff on wool in a double-action manner, that is, provide the necessary additional financial assistance to wool growers to compensate for the inadequacy of the tariff by payments limited to a portion of the duties collected on wool imports. In this way, the industry will in effect be self-supporting. The net cost to the government will be small in relation to the advantages from the standpoint of our national welfare and foreign policy.

Later in the hearings, SENATOR CLYDE R. HOEY of North Carolina asked Assistant Secretary Rizley about the unique funding feature in more detail.

SENATOR HOEY: I believe the amount realized on imports on wool over the past few years has ranged from $45 million to $50 million a year.

MR. RIZLEY: I believe so.

SENATOR HOEY: This bill contemplates taking up to 70% of that amount to meet this payment?

MR. RIZLEY: That is right.

SENATOR HOEY: If it reaches 70% and it is still not enough, then it goes over to supplement import duties for future years?

MR. RIZLEY: That is right.

SENATOR HOEY: In the meantime, the farmer would be paid by the CCC and the CCC would be reimbursed when the imports arose sufficiently to take care of it?

MR. RIZLEY: That is right. From the studies made, we doubt seriously — I think it is questionable whether we would ever have to call on the CCC to be reimbursed other than as provided from tariff duties unless of course the tariff should be taken off.

SENATOR EARLE C. CLEMENTS of Kentucky also remarked about the expense to the American taxpayer.

SENATOR CLEMENTS: Mr. Secretary, as I understand your statement and this measure, under no condition would this matter of handling the wool cost the Federal Treasury a dollar other than that which comes from the 70% of the tariff on imported wool.

MR. RIZLEY: That is correct.

SENATOR CLEMENTS: There is one feature of it that I like very much and this is that you are endeavoring to support it through the tariffs on its competition.

MR. RIZLEY: Yes, sir.

On April 27, 1954, the Senate passed the Wool Bill by a vote of 69-17. On July 2, the House passed H.R. 9680, the Omnibus Farm Bill, which included the Wool Bill. The Wool Act of 1954 became law on August 28, 1954. It has been renewed as a part of the Omnibus Farm Bill ever since, most recently in 1981.

Over the life of the program, $3.6 billion has been collected in wool tariffs; $1.4 billion has been paid to producers in lieu of higher tariffs and the remainder of the tariffs, $2.2 billion, has gone to the General Treasury. The only regret is that more tariff money has not been generated. During the 1954 hearings, Assistant Secretary Rizley assured the Senate Agriculture Committee that no further reduction would be made in wool tariffs.

SENATOR BARRETT (WYOMING): Might I ask, Mr. Rizley, one question? In your statement, you say the tariff established to protect the industry would be continued. I assume by that you meant the present tariff of 25 and one-half cents would be continued.

MR. RIZLEY: That is correct.

SENATOR BARRETT: During the life of this program?

MR. RIZLEY: That is correct.

The tariffs on wool have since been reduced from 25 and one-half cents per pound to 10 cents per pound, a 61% reduction. Thus, since 1947, wool tariffs have gone from 35 cents to 10 cents per pound, a 71% reduction, not even accounting for inflation.

Were the Wool Act to be abolished or rendered ineffective, it is almost certain that the State Department would soon give up the remaining 10 cents a pound duty, thus costing the General Treasury over $200 million a year.

The Wool Act was begun to protect U.S. wool producers from an acknowledged inadequacy in the tariff level. That level is even less today.

The only protection the producers of U.S. wool have from foreign imports is the Wool Act, and if the sheep industry is to continue, we must continue to make those who export wool to the U.S. pay for the disruptions they create.

The mohair program has not had as large a cumulative effect on producers as the wool program. The mohair program is credited, however, with saving mohair production in the United States after a critical economic period preceding the passage of the Wool Act. Government payments have been far less frequent, as the real value of mohair generally has risen since the late 1960's. However, the support level has been above the market price since 1981. Compared with no program, the difference has encouraged production, lowered market prices, raised producer receipts, and increased mohair exports. The demand for mohair is growing, and the renewal of the wool and mohair program will help U.S. producers meet that demand.

The decline in the number of sheep in the U.S. over the past few years is due to economic factors. One of those economic segments is the incentive program, which according to USDA, has helped to resist the decline in numbers. (See Figure 1, Page 3.) Unfortunately for sheep producers, the economy of rural America and our military preparedness, the incentive program has been stifled at times when its impact could have been significant. Wool prices are the lowest of all commodities in relation to parity — 25%!

The formula in the Wool Act was designed to bring the prices closer to parity — parity being the cost of production measured against the price received for products sold in 1967 dollars. The formula in the Wool Act has been adjusted downward over the years, even though the original language of the Wool Act provided for payments as high as 100% of parity. During the 1960's and the early 1970's, the support price was frozen, while production costs soared, and prices paid to the producer declined. Thus, the Wool Act was rendered largely ineffective at a time when it could have played a major role in preventing the exodus of wool growers if it had been allowed to function as conceived.

We hope that Congress won't make a similar mistake in 1985, when again the need for a fully functional incentive program is so apparent.

Wool comprises a substantial 30% of the gross income on an average sheep operation.

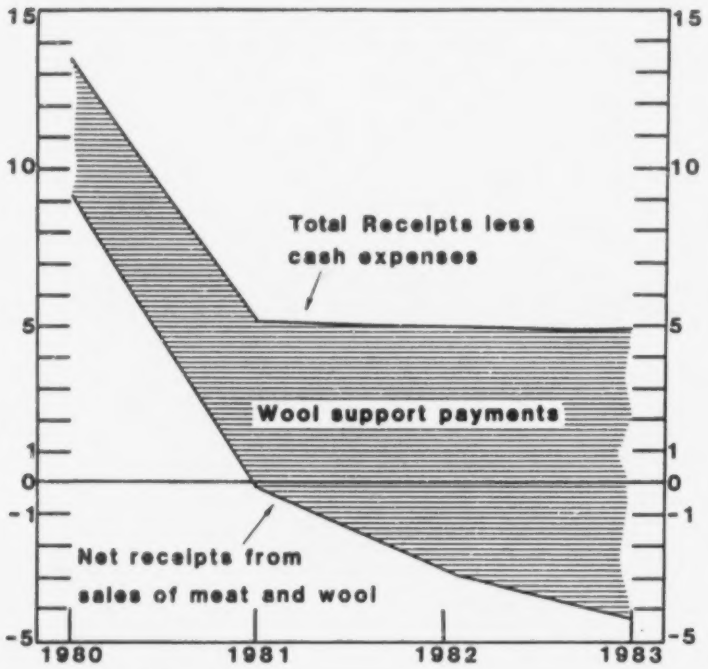
Congress should note that in 1980 and 1981 when the price of lamb and wool escalated, the number of sheep in the U.S. *increased* for the first time in 30 years.

One of the most important reasons to continue the Wool Act is to ensure a domestic supply of wool in the event of an international crisis or foreign conflict. Section 702 of the Wool Act of 1954 states that

"It is hereby recognized that wool is an essential and strategic commodity which is not produced in sufficient quantity in the United States to meet domestic needs . . ."

FIGURE 1

U.S. SHEEP PRODUCTION COSTS
(Average Per Ewe)



SOURCE-USDA/ERS BULLETIN # 466,1984
WESTERN LIVESTOCK MARKETING INFORMATION PROJECT

S-5-14

CHART UPDATED 10/24/84

and ". . . It is hereby declared to be the policy of Congress, as a measure of national security, to encourage the annual domestic production of approximately 300 million pounds of shorn wool . . ."

When Hitler's army was caught before reaching Moscow by an early winter, they lacked adequate wool clothing and wool blankets. It was the turning point in the campaign, possibly the entire war. The beginning of World War II saw France turning to America for wool uniform cloth and blankets which they could not supply from their own large textile industry. England was also unable to supply its own needs, and many U.S. mills ran full-out during 1938 and 1939 making wool clothing for the British armed forces.

Today our leaders are no less aware of the importance of wool, and for its immediate and assured supply in case of conflict. Colonel Kenneth W. Shedd, U.S. Air Force Chief of Clothing, recently told the American Wool Council:

"You are aware of the many applications of wool through analysis; I am aware of their applications through personal use. Whether it is in the Arctic or high-level flight, I have personally judged the effectiveness of wool garments. Our nation depends upon you to take pride in your individual efforts and produce the very best product you can.

If, God forbid, our nation should be faced with another conflict in the future, wool will be as important then as it has been in the past.

The development of modern aircraft and sophisticated equipment will never negate the need for the personal protection and comfort that wool can provide."

Senator John Tower, Chairman of the Senate Armed Services Committee, remarked last year:

"While it is true that wool blends are being used more often (in the military), this does not undermine the critical need for adequate domestic supplies of wool . . . the Wool Act has done its job in allowing our nation to be independent of foreign sources of wool in case of conflict. This, in my opinion, is reason enough to continue the Wool Act and does not justify reducing the Act to the point that we become dependent on foreign sources of wool, which may be cut off in time of war. In light of the problems faced by Britain as it recently faced a shortage of cold weather clothing while engaged in the Falkland Islands, I feel it is important for us to remain committed to our domestic industry. **Wool remains vital to our nation's armed forces, and a domestic supply is essential. As Chairman of the Senate Armed Services Committee, I shall continue to support this concept."**

Not only did the British suffer from cold in the Falklands because of a lack of wool, but British sailors died needlessly because their ships were a floating fire trap. This was the conclusion of an investigation conducted by *New Scientist Magazine*.

One of the most glaring mistakes (according to their report) **was that British sailors were wearing polyester uniforms that melted on to their skins.**

On some ships that were hit, sailors fought fires wearing "number six" tropical dress uniforms made from white cotton, even though it was below freezing. They had to wear this clothing because their standard issue, made of synthetic fibers, melted and stuck to their skins in fires. In the U.S., the Navy Safety Center concluded that clothing made from 100% polyester poses a serious burn hazard because it melts and clings to the skin when exposed to temperatures in excess of 500 degrees Fahrenheit. The Center also learned that, short of melting, polyester also has enough heat retention properties to convert a first degree burn scald into a second degree burn.

Of equal significance, the Wool Act is *critical* to the nation's domestic welfare and economy. Sheep are raised in all fifty states. The industry is a major source of income in 34 of these states and is considered vital to over 200 counties of the nation. Over 125,000 families earn their living, all or in part, from sheep. Sheep are often the glue that helps hold a farming operation together. They provide an income source that otherwise wouldn't be available to many farm operators.

They are usually managed as a family enterprise, capitalizing on labor inputs from spouse and children.

In addition, the wool processing/manufacturing labor force (direct employment) is estimated at 33,200 persons, with an approximate payroll of $488,000,000. "Ripple effect" jobs created by the continued existence of the wool industry, number 350,000, largely in rural areas where alternative employment opportunities are scarce. Often these jobs engage persons of limited employability, persons who otherwise would seek unemployment and social welfare support.

In all, the sheep industry and its allied businesses CONTRIBUTE OVER $2 BILLION ANNUALLY TO THE U.S. ECONOMY.

As such, the U.S. sheep industry is a vital and essential force in American life, and to its economy. And the Wool Act is a significant, determining factor in the continuation of the industry. According to a 1984 study conducted by the U.S. Department of Agriculture: "Without a government income support program, the average sheep producer would have

only broken even in 1981 and operated at a loss during 1982 and 1983. Total revenue from the sales of meat and wool, less cash expenses, declined from about $9 per head in 1980 to a loss of over $4 in 1983. Thus, total wool cash receipts have become important to sheep producers, increasing from 21% of all cash receipts in 1980 to 34% in 1983.

Without an effective Wool Act, thousands and thousands of farm and ranch families, sheepmen and women, may have no choice but to go out of business.

Many communities and many allied industries would be placed in serious jeopardy. Another chapter in American agriculture would be forever closed.

In 1954, the U.S. government made, in effect, a contract with the U.S. sheep industry. They said, "We won't do what is recommended, that is raise the tariff to an acceptable level, but we will use the collected tariffs to make up for your lack of protection." The sheep industry signed on. The government also promised not to lower the tariff on wool any further. Later they were lowered an additional 61%, despite the predictable consequences, voiced by sheepmen, of decreasing sheep populations and increasing import levels.

The industry and its people have worked and struggled and scraped to stay above water. And they have. They accepted the calamitous World War II freeze on the price of wool, so that our fighting men might stay warm and our nation strong. They overcame a two-year drought in the Southwest that forced an unprecedented liquidation. They overcame a killer storm in 1984 in the Rockies and the Plains that claimed over 250,000 head of sheep. They battle day-in and day-out, a proliferation of coyote predation that steals $80 million from the industry yearly.

The American sheep industry will continue to fight to preserve its unique way of life and to provide food and fiber for the nation. Sheep will graze the ranges, harvest the renewable resources of the mountainsides where no crop is grown and continue to graze the marginal farm lands where farmers need a margin of income to live on. And, sheep production will continue on lands where any crop or livestock can prosper, because the farmers and ranchers know that raising sheep is a rewarding business and a good way to help feed their kids and help pay for their education.

In return, we ask only that Congress continue the Wool Act; to help to offset the impact of imports; we ask that Congress insist that those who export wool to the United States help pay to keep our industry alive, instead of the American taxpayer. The wool and mohair program has worked, has been successful and deserves the continued support of the Congress.

COMMONLY ASKED QUESTIONS

Q. *What is the Wool Act?*

A. The Wool Act, authorizing the wool and mohair program, is Section 7 of the Agriculture and Food Act of 1981, which reauthorized the program through December 31, 1985.

Q. *Why was it passed?*

A. The Wool Act was enacted in 1954 to reimburse U.S. growers for markets lost to overwhelming levels of imports, resulting from substantial tariff reductions on raw wool. It also was enacted to assure a domestic supply of wool for strategic military purposes.

Q. *How is the Wool Act funded?*

A. The Wool Act is funded from tariff collections on certain categories of raw wool and wool fabrics, which are placed in the General Treasury of the United States. 70% of the amount collected, according to the legislative language, can be used to make "incentive" payments to wool producers under the Commodity Credit Corporation program.

Q. *What is the "incentive" feature of the program?*

A. The incentive feature is provided because the grower who does a better job of preparing and marketing his wool clip receives a higher payment than those who don't. This unique aspect of the wool and mohair program was conceived to encourage producers to strive for improvement in the quality of their clip.

Q. *What impact does the Wool Act have on the U.S. Treasury?*

A. The excess tariffs collected over payments made to growers, and the 30% of the tariff assessments reserved by law, are retained in the U.S. General Treasury. Over the life of the program, this has added up to a figure in excess of $2.2 billion. It is notable that the payments to growers has never reached the 70% limit imposed by the legislation.

Q. *How many other commodity programs have this unique feature?*

A. None! The wool and mohair programs are unique in many ways. They don't create surplus commodities, storage problems and export problems. And as mentioned above, there is no tax liability for the American wage earner because of these payments.

Q. *Is U.S. wool vital to the nation's national security?*

A. According to several contemporary experts, wool is certainly vital to our national security. Senators, Congressmen and professional military people agree that an available domestic supply of wool is essential in the event of a military conflict where adverse weather would be expected.

Q. *Could the sheep and goat industry survive without the Wool Act?*

A. The increasing levels of subsidized imported wools and woolen fabrics, an inadequate predator control program and increasing operational costs due to regulatory compliance in recent years, all serve to emphasize the economic importance of the wool and mohair program. Reductions or elimination of the Act would create a panic in the sheep and goat industry.

Q. *Is the Wool Act important to small producers?*

A. Yes, because the payments are relative and based on the amount of wool or mohair produced. A payment of 70 cents a pound on wool is the same, in relation to an animal unit of output, regardless of whether the wool grower has 30 sheep or 300 sheep. In addition, small flocks of sheep are the mortar that helps to keep a variety of agricultural operations together. These payments are ultimately spread through the economies of hundreds of small rural communities.

Q. *Does the Wool Act increase prices to the consumer?*

A. No, in fact the opposite is true. The amount of wool in a garment is almost incidental to its retail cost. For example, there are about 4 pounds of wool in a men's 100% wool 3-piece suit. The value of that wool would be $2.80 and the suit would probably sell for $250-$400. Along the same line, claims that the wool tariff increases the cost of a retail product is false. A 10 cent per pound tariff, means that the tariff cost of a $250 wool suit is 40 cents! The Wool Act actually decreases the price of the product to the consumer, because the tariff collections are used in part to pay the producer for his wool. This means the domestic processor acquires his raw material at a lower cost.

Q. *Does the nation's textile industry benefit from the Wool Act?*

A. The nation's textile industry is a secondary beneficiary of the wool and mohair program. As noted above, they secure their raw product at a lower cost. The serious decline in the number of textile plants in the U.S. is a direct result of unimpeded imports of both wool and artificial fabrics into the U.S. The reduction or elimination of the Wool Act would precipitate even greater levels of subsidized imports and fewer domestic mills and the jobs they provide.

Q. *Adjusted for inflation, have Wool Act payments increased or decreased over the years?*

A. In real dollars, the payments have steadily decreased over the years. (See Figure 2, Page 7.)

FIGURE 2

WOOL SUPPORT PRICES AND MARKET PRICES*

YEAR	SUPPORT PRICE	MARKET PRICE	DEFLATED SUPPORT PRICE	DEFLATED MARKET PRICE
	cents per pound			
1938	18.0	19.1	42.9	45.5
1939	18.0	22.3	42.9	53.1
1940	—	28.4	—	67.6
1941	—	35.5	—	80.6
1942	41.7	40.1	85.1	81.8
1943	42.4	41.6	81.5	80.0
1944	41.9	42.3	79.1	79.8
1945	42.3	41.9	78.3	77.6
1946	42.3	42.3	72.3	72.3
1947	42.3	42.0	63.1	62.7
1948	42.3	49.2	58.8	68.3
1949	42.3	49.4	59.6	70.0
1950	45.2	62.1	62.8	86.2
1951	50.7	97.1	65.0	124.5
1952	54.2	54.1	67.8	67.6
1953	53.1	55.0	66.4	68.8
1954	53.2	53.2	65.7	65.6
1955	62.0	42.8	77.5	53.5
1956	62.0	44.3	76.5	54.7
1957	62.0	53.7	73.8	63.9
1958	62.0	36.4	71.3	41.8
1959	62.0	43.3	71.3	49.8
1960	62.0	42.0	69.7	47.2
1961	62.0	42.9	68.9	47.7
1962	62.0	47.7	68.1	52.4
1963	62.0	48.5	67.4	52.6
1964	62.0	53.2	66.7	57.2
1965	62.0	47.1	66.0	50.1
1966	65.0	52.1	67.0	53.7
1967	66.0	39.8	66.0	40.0
1968	67.0	40.5	64.4	38.9
1969	69.0	41.8	62.7	38.0
1970	72.0	35.5	62.1	30.5
1971	72.0	19.4	59.5	16.2
1972	72.0	35.0	57.6	28.0
1973	72.0	82.7	54.1	62.2
1974	72.0	59.1	48.6	40.0
1975	72.0	44.7	44.7	27.8
1976	72.0	65.7	42.4	38.6
1977	99.0	72.0	54.7	39.8
1978	108.0	74.5	55.4	38.2
1979	115.0	86.3	53.0	39.8
1980	123.0	88.1	51.4	37.0

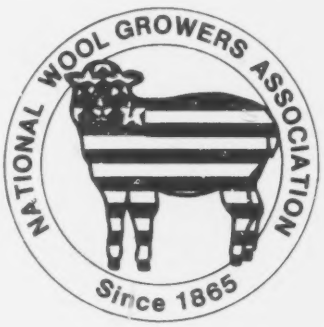
*The deflator is the consumer price index (CPI), 1967 = 100.

Q. *What are some of the advantages of the Wool Act?*

A. The Wool Act is a market oriented payment program, exclusive of taxpayer support. The target price, set annually, reflects interest rates, inflation, cost of production and the world pricing structure. This target price can vary up or down depending on these factors. Thus the program reflects actual market conditions. The wool and mohair program provides continuity to a producer and to his financial backers. It creates a partnership between the grower and the banker, and enables the grower to make both short and long-term management plans.

Q. *Would the industrywide advertising and promotion program continue if no payments were made?*

A. The funds for the industry's self-help advertising and promotion program are derived under the auspices of the Wool Act. These funds are withheld from grower payments made under the wool and mohair program. It would be difficult, if not impossible, to organize a program comparable to the present market development oriented approach without the mandated check-off.



Senator PRESSLER. Well, thank you both very much for your comments.

I have a series of questions on the impact of credit on small businesses on the main streets of your towns and on your industries.

Senator Bumpers has arrived and I would ask him if he has any statement or questions.

Senator BUMPERS. Mr. Chairman, I want to thank you very much for deferring to me on this because I am going to have to leave in a few minutes, but I just want to say to both of you gentlemen that I have enjoyed reading and hearing your respective testimonies this morning, and thank you for coming.

I want to say first of all, Mr. Meyer, and this is certainly no denigration of your testimony, but we don't have a wool industry in my State. And you know how parochial we politicians are around here, but we're concerned primarily about our farmers in our particular States.

But I want to say to Mr. Johns that it is my intention to put your testimony in the Congressional Record because I think it is one of the most poignant, concise descriptions of what has happened to the American farmer that I have seen. It is something that I've been trying to say, but which you say much better in your testimony. And that is, No. 1, we're not trying to save every single farmer in this country. In the first place, we couldn't do it if we wanted to. No 2, we'd be doing ourselves and those farmers a disservice. There are inefficient farmers, and there are inefficient producers, inefficient managers, just like there are in any business. The Small Business Administration is not trying to save bad businesspeople; we're trying to give those who could and would be good managers a break to stay in business and make it.

But you point that out in what I think is a very cogent way, and I want to thank you for it and I want you to know that you have expressed my sentiments better than anybody I've heard in the past 2 months who have talked about this.

Mr. JOHNS. Thank you, Senator Bumpers.

Senator BUMPERS. Thank you, Mr. Chairman.

Senator PRESSLER. Let me ask each of you, on the main streets of the towns that you're familiar with, what impact is the agricultural crisis having? You've elaborated somewhat in your statements and in the businesses that you're familiar with. Each of you work in a different form of agriculture, and I think that's good; and let me say that I think that the statements on wool are very relevant here because it's important in western South Dakota, and we're going to make sure that the Ag Committee and the Congressional Record have that, because that's a very important segment.

But if, for whatever reason, the crisis continues or if the wool situation gets worse or if the agricultural situation gets worse, review again exactly what's going to happen to the small businesses on your main street, or the businesses in general.

Mr. JOHNS. Senator Pressler, in the town of Hillsboro, OH, there are 6,500 people, and it's the county seat. There are three implement dealers, all hanging on by the skin of their teeth. Two of the implement dealers bank with our bank, so I am familiar with their financial condition. One of them has used up his entire business equity and has nearly eroded all of his personal equity to keep his

business in operation. Personally, I don't know why he has stayed this long.

Another implement dealer who about 12 years ago, I believe, had an SBA loan, was more prosperous and is hanging on, and I believe he'll make it.

Another implement dealer who also owns a farm that is taking him down isn't going to make it.

So there's our three implement dealers, one of which I see surviving. The other two, I don't believe they will survive. Our local cooperative, called Landmark, in Ohio, went bankrupt 2 years ago; $18 million in annual sales and a considerable amount of employment. They went totally bankrupt and out of business, and an independent merchant has purchased part of the facilities and is operating it on a much lesser scale.

And then there's "uptown merchants," I call them, the dry cleaners, those type of people. Many of those are in—they are much smaller operations; they don't need the large influx of capital that we need in agriculture to operate our businesses, but they are struggling, also.

Senator PRESSLER. What about in western South Dakota in this area where wool is so important? I appreciate your bringing those things to our attention, because we don't hear much about that in this subcommittee or, indeed, in Congress, not enough. We're going to make sure that it's heard about more.

What is the impact there, on some of your communities?

Mr. MEYER. Senator, in South Dakota in the past 12 months we've seen a decline of approximately 14 percent in sheep numbers. These declines have been for two reasons. One, we had the massive spring storm last April; and second, we've had many liquidations of sheep people that weren't able to meet their loans at the bank and the banks would not extend further credit, and they were liquidated.

In addition to that, a year ago at this time I had already marketed—sold ahead—over $500,000 worth of wool because the demand, United States-wide, was outstanding. I have sold one load of wool this year, valued at about $28,000.

The point I'm bringing out is, the sheep industry, the livestock industry has three cash payments per year. They clip the sheep in the spring, sell that wool and use that money for cash flow. They receive their incentive payment in April, providing more cash flow, and then market their lambs in the fall. Now, we're going into our heaviest part of the shearing season immediately, and I have no market for wool. I can't sell wool for any price. I call the manufacturers in the United States, even call foreign manufacturers, and there's no demand for wool.

So it causes a severe cash flow problem. These operators normally depend upon this income from selling their products. And like Mr. Johns mentioned, the banking industry has indicated that they have many, many bad loans. The Bank of Belle Fourche told me that they had approximately 30 percent of their loans that are in jeopardy, and they are primarily livestock loans. So these people are in jeopardy. Their debt load is tremendous.

So it's being reflected right on main street, like I indicated in my statement earlier. The main street of Sturgis, SD—30 businesses on

main street and 9 of those have closed in the last 12 months, which is almost 30 percent, and the balance are holding on on a day-to-day basis. It's very, very serious, it's going to get more severe if something isn't done, immediately!

Senator PRESSLER. I appreciate that very much. So there is a crisis in small business as well as in agriculture. And I appreciate your comments about the elimination of the Wool Act, and I'm going to be sure that that is also submitted to the Agriculture Committee and to the Finance Committee, and I'm also going to place your statement in the Congressional Record.

Now, the strength of the dollar is having quite an impact on exports, and I know that you export a lot of wool to Mexico and you're an international man by virtue of your position. Is it mainly the strength of the dollar that's causing problems?

Mr. MEYER. Yes; the strength of the dollar probably would be 90 percent of the problem that we're having in our industry today. The strong dollar makes foreign wool, foreign clothing, foreign cloth much cheaper. Every time the dollar appreciates more, that dollar buys more foreign products. That same dollar makes foreign wool markets cheaper.

Now, American business, American textile manufacturers have high labor costs. We're unionized in this country. Even before the dollar got strong we were becoming uncompetitive due to high labor costs. Now, when you take the high labor costs coupled with the dollar that's appreciated close to 100 percent in the last 4 years, it's very devastating to the domestic manufacturers, and that's being reflected immediately back to the livestock producers. So the strong dollar is raising havoc domestically, and also internationally.

Senator PRESSLER. I'll ask a final question of each of you. What legislative recommendation—and you've covered this to some extent with the Wool Act and with some of the FmHA recommendations—but would you each just review what steps, what legislative recommendations you'd like Congress or the administration to take in the next few months?

That's the $64 question.

Mr. MEYER. If we could provide some credit needs at an interest rate that would be conducive to helping agriculture stay in business. In other words, interest rates have come down, and we're all happy about that; but in no way can a livestock producer borrow money at 13 percent and 14 percent business and stay in business and sell his products at depressed levels. To indicate at this time the effect that that's having, a year ago at this time domestic fine wool was bringing $1.25 a pound. A ewe will shear approximately 10 pounds; that's $12.50 a head. That same market today is about 70 cents a pound, so it's almost half. It's devastating. There's no way we can pay 14 percent interest and sell wool for 70 cents a pound. I've been in the business 25 years; I was paying 60 cents a pound for wool 25 years ago, when we were having interest rates at 4, 5, 6 percent and our operating cost was a fraction of what it is today. So we definitely need credit rates to come down, and we need some protection from imports. Something's got to be done about the strong dollar. The strong dollar is killing agriculture like nothing else.

Mr. JOHNS. Senator Pressler, I agree with two of Mr. Meyer's points. The strong dollar is also killing the grain market. I do not know what can be done about that; you gentlemen know more about that than I. I believe the short-term need is some type of guaranteed loans to get money to the farmers in the next 2 or 3 weeks; but, during 1985, we need a long-term market-oriented program from the USDA. Someone here knows how to develop that type of a program to market our grain outside the country. Yes, the dollar is killing the sale of the grain. Those people in these other Third World countries need grain. There must be a way that we can get this grain to them to feed their people, because they don't have the money to pay our high dollar prices. We need a long-term, market-oriented program, instituted in 1985.

Thank you.

Senator PRESSLER. I thank you both very much, and I want to say how proud I am of both of you; and to my constituent, whom I hope to see at lunch today, I welcome you here and we'll have further talks.

I want to thank both of you, and I want to call our next panel forward. Our next panel consists of the representative of the National Farm & Power Equipment Dealers, John Mullenholz of the law firm Neal, Mullenholz, Shaw & Seeger; also, Ms. Aliceann Wohlbruck, the executive director of the National Association of Development Organizations.

Please come forward.

Let me also say that if my four farmers from South Dakota are still here and are able to stay, they might be thinking of testimony. The purpose of this hearing is to look upon the impact of the agricultural crisis on other areas, and I know that at least two of those farmers are school board members. It may be very useful to see what impact the agricultural crisis is having on the school board financing in some of these small communities, and so I hope that our farmers stay and—unless there is objection—since they are not scheduled witnesses, I will ask for unanimous consent to give about 10 minutes to them, collectively, if they can make their plan as to their testimony.

But at this point we have two scheduled witnesses, John Mullenholz, representing the National Farm & Equipment Dealers, and Aliceann Wohlbruck, representing the National Association of Development Organizations.

Aliceann, I think perhaps we'll call on you first.

STATEMENT OF ALICEANN WOHLBRUCK, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

Ms. WOHLBRUCK. Thank you, Mr. Chairman. I am the executive director of the NADO, and normally I would not testify myself but our board of directors was just in last week, and as you know, rural folks don't have money to travel to Washington all the time so I am testifying on their behalf today.

NADO's members are locally based organizations whose primary focus is on business, community, economic, and rural development in small towns and rural areas. In fact, we are so rural that we have two board members on our national board from South

Dakota. Bill Folkerts is from Watertown, and Lyle Richter from Britten.

I'd particularly like to thank you for inviting NADO to testify so that we can talk about the relationship between the farm crisis and the economy of rural areas. The interrelationship is often overlooked when the farmers' problems are discussed, and we appreciate your interest and support.

Last week when our board met we released an issue paper entitled "The 1986 Budget: What Does it Mean for the Development of Rural Areas and Small Cities?" I would like to ask that this report and my entire testimony be made a part of the hearing record.

Senator PRESSLER. Without objection, and if staff will take a look at it—how many pages is it? They're always after me about printing costs. It's not too long, is it?

Ms. WOHLBRUCK. No; I'd be happy to work with them to summarize it.

Senator PRESSLER. Yes; work with staff to summarize it down to keep everybody happy, but that's fine. The chairman is always after me about printing costs, and so when we put things in the record—once in a while a witness will say, "May I put this brief report in?" and it will be 200 pages, and then we have to get an agreement with staff.

Ms. WOHLBRUCK. Well, we're a very small organization on a very small budget, Senator.

Senator PRESSLER. Good. OK. Great. No, I'm not worried about that. I always say that so staff's got some flexibility. Thank you.

[Material follows:]

NADO

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THE 1986 BUDGET -

What Does It Mean for the Development of Rural Areas and Small Cities?

The National Association of Development Organizations (NADO) was founded in 1967 to promote economic development in small towns and rural areas. NADO's members are locally-based development organizations who are involved in economic, community, business and rural development activities designed to create and maintain private sector employment.

ELIMINATING SMALL PROGRAMS - DO THEY MATTER?

In the debate about big budget cuts and big deficits, the problems of small towns and small businesses that small federal programs are designed to help are in danger of being ignored. Programs like the Economic Development Administration (EDA), Appalachian Regional Commission (ARC), Farmers Home Administration (FmHA) and the Small Business Administration (SBA) have helped thousands of companies and localities to create private sector jobs. The charts on pages 7 and 8 show that the development programs which are most important in rural areas would be totally eliminated. Given the current economic situation in rural America these proposals raise serious questions about equity for rural citizens.

With thousands of farmers and hundreds of banks facing bankruptcy, the national media have discovered that all is not well in rural America. The radical chic of the '60s apparently is being replaced by the rural chic of the '80s as evidenced by recent movies dramatizing the plight of farm families and nightly television stories on farm foreclosures. The question is whether the Congress will be willing to evaluate the proposed cuts, not only in terms of dollars (few as they may be in terms of the total budget), but also in the context of large areas of the country which are not participating in the current economic recovery.

This issue paper is designed to help local, state and national policymakers and media representatives examine the President's budget proposals in light of economic situations in rural areas and small cities.

WHAT DO RURAL CITIZENS WANT?

> Whether farmers or not, all rural citizens should have the same consideration as those who live in towns and cities in economic development, energy, credit, transportation availability and employment. Opportunities for non-farm jobs have become increasingly important to farm and ranch families, enhancing life and work in rural America. (Emphasis added)
> -- 1984 Republican National Convention Platform

RURAL ECONOMIC DEPRESSION

The general economic recovery of the past two years has bypassed many rural areas. The prolonged economic recession beginning in 1980 has retarded rural economic growth and diminished the ability of rural areas to retain, let alone attract, people. While metropolitan population has continued to grow at the same rate as during the 1970s, the growth rate for nonmetropolitan areas has fallen to about 60 percent of that enjoyed during the past decade, largely due to the greater severity of the economic recession in small towns and rural areas. As pointed out by USDA's Economic Research Service, "Unemployment, discouraged workers, and involuntary shifts from full-time to part-time work schedules all increased more rapidly among nonmetropolitan residents than those in metropolitan areas."

The nonmetropolitan economy has failed to perform as well as the metropolitan economy during the 1980s. Not only have there been problems in the agricultural sector, but also many of the nonfarm industries in rural America are mature, slow-growth industries that tend to relocate to low-wage locations such as Third World countries. One result is that by 1982 the nonmetropolitan unemployment rate exceeded the metropolitan rate by two percentage points.

Another result is that in 1983 the nonmetropolitan median family income was only $20,938, while the metropolitan median income was $26,488 (27 percent higher). In fact, while the metropolitan median increased by 17.3 percent between 1980 and 1983, the nonmetropolitan median increased only 15.9 percent (while the Consumer Price Index rose by 20.9 percent). One effect of this was that the nonmetropolitan poverty rate increased from 15.7 percent in 1980 to 18.3 percent in 1983.

Rural America includes virtually all of the areas of severe and prolonged poverty. All of the counties that have had consistently low incomes since 1960 are nonmetropolitan. In short, rural America is the home of an economic underclass.

WHY SHOULD THE URBAN MAJORITY CARE ABOUT THE RURAL MINORITY?

Approximately one-third of the population lives in what the Census classifies as rural or nonmetropolitan areas. In addition, many more people live in small metropolitan areas whose economies are tied to agriculture or other rural-based industries such as forest products, mining and oil. These are the individuals, governments and businesses who make up NADO's membership.

The financial problems of many farmers and the consequent liquidity problems of small, rural banks have been given significant publicity of late. Clearly, many of those troubled financial institutions are in no position to provide adequate credit on affordable terms to local non-farm businesses. Rather, they are faced with substantial losses on existing farm loans that could impair their capital and lead to their closure.

For rural small businesses already confronted with historically high real interest rates on commercial loans, elimination of more favorable, alternative sources of debt financing is likely to spell disaster in one form or another. Those unable to obtain or afford bank loans almost surely will go under and others could face even higher borrowing costs in the absence of the influence on rates exerted by the availability of federal credit assistance.

The Independent Bankers Association of America which represents small, mostly rural, banks recently reminded Congress of the inter-relationship of the various contributors to the rural economy:

> While only three percent of the population is directly involved in agriculture, 20 percent is dependent on ag-related industries. Consumers as a whole have long enjoyed a cheap food policy. If you permit agriculture to continue to deteriorate and producers to continue to fail, food will necessarily be more expensive. The ag bank does not operate in a vacuum. It is a building block of the community -- often the only financial institution in the community. If it goes, the school and Main Street are next.

Congress and the American people should understand the consequences before they follow the lead of the administration's "anti-subsidy" rhetoric in the name of deficit reduction. Good public policy cannot be made in the absence of open, informed deliberation -- a complex budget reconciliation bill rammed through quickly may be politically expedient for those who craft the bill, but it is not likely to yield equitable treatment for those affected, particularly the rural minority.

HISTORICAL ANTECEDENTS

A study of American economic development reveals that in 1791 the House of Representatives requested Secretary of the Treasury Alexander Hamilton to prepare a plan "for the encouragement and promotion of such manufacturing as will render the United States independent of other nations for essentials, particularly for military supplies." In response, Secretary Hamilton proposed a system of direct subsidies for "infant" manufacturing industries (which would be allocated by a government commission) and the improvement of internal transportation (as part of a comprehensive plan of internal improvements). One of his guiding principles was the concept of a balanced national economy.

History shows that the federal government has directly, albeit intermittently, intervened in support of local economic development as part of a national development strategy at least since 1806, when it enacted a law providing for the construction of the National (Cumberland) Road. Shortly thereafter, Albert Gallatin, then Secretary of the Treasury, submitted his farsighted, comprehensive plan of internal improvements. After the federal government subsequently withdrew its support for internal improvements (with the onset of the War of 1812), the nation experienced a loss of industrial base and a series of economic depressions as state and local governments pursued promotional and developmental activities on a less comprehensive and cohesive basis. Eventually the federal government again pursued economic development with the Land Grant Act of 1850, the Homestead Act of 1862, and the Morill Land Grant Act of 1862.

When the federal government withdrew from development activities and began running budget surpluses after the Civil War, income inequalities widened, poverty increased, unemployment rates rose, the disparity between agricultural and nonagricultural incomes grew, and the nation suffered several of its longest and most severe economic depressions. If the past is prologue, acceptance of the Reagan budget could produce similar consequences.

STATIC ZERO-SUM GAMES VS. DYNAMIC ECONOMIC EQUITY

The Reagan administration claims that federal programs supporting local economic development efforts merely redistribute economic activity without enhancing the national economy. Their position is that such redistribution is not a legitimate function of the federal government, thus such programs should be terminated.

One can argue with both of these premises. First, a mere redistributive effect assumes a static economy, contrary to the administration's optimistic economic forecasts of GNP growth, and it ignores the fact that economic activity locations are not free of public sector influences. Clearly "market" forces do not ignore the public sector -- businesses tend to locate in places that contribute to profit maximization and the public sector establishes much of the context determining whether locations are advantageous or not.

Congress has enacted "anti-piracy" prohibitions for programs such as those of the Economic Development Administration. The clear intention is that such programs must not be used to relocate existing employment opportunities from one locale to another. Legislation also prohibits the use of such programs to contribute to "overcapacity" in and industry, which could indirectly result in the redistribution of employment opportunities through the closure of less profitable production facilities.

THE BIG PICTURE - BUDGET SHIFTS NOT BUDGET CUTS

The proposed budget totals $973.7 billion in outlays, which is an increase over last year. (Budget outlays are the actual payments made in a fiscal year, as opposed to the budget authority provided by law which may be spent over a period of time.) Of this amount $282.4 billion or 29 per cent is for military spending; $97.4 billion (10 per cent) is for state and local governments; $399.2 billion for direct benefit payments to individuals (41 per cent); $146.1 billion for interest on the debt (15 per cent); and $48.7 billion (5 per cent) for federal operations.

According to the budget document, if all of the President's requests were adopted there would be a savings of $50.8 billion. Nearly 82 per cent of the cuts ($38.8 billion) are in nonmilitary spending, and $8.7 billion in military savings is counted because the President reduced his request for the levels projected in the summer of 1984. Another $3.3 billion is counted as savings on the national debt.

DEFENSE, SOCIAL SECURITY, INTEREST MAKE UP TWO-THIRDS OF BUDGET

The President has requested increases in spending for defense (13 percent), Social Security (5 percent) and interest on the national debt (9.3 percent) which together make up two-thirds of the federal budget. In the remaining third of the budget, spending would be cut 10 percent below current levels.

According to the budget, federal grants-in-aid to state and local governments would be cut from $107 billion in 1985 to $100.6 billion of outlays in 1986. Almost half of this category is composed of programs such as Aid to Families with Dependent Children (AFDC), food stamps, medicaid, housing assistance and other welfare programs which are passed through states and localities to individuals. (These programs were known as the social safety net in earlier budget battles.)

$1.8 BILLION IN RESCISSIONS REQUESTED IN 1985 SPENDING

In addition to reductions and eliminations in domestic spending for 1986, the President has requested $1.8 billion of rescissions in funds already appropriated for this fiscal year. (A rescission is a request by the President to the Congress to cancel budget authority previously enacted by the Congress and approved by the President.) Of major concern to NADO members are the $179 million rescission for EDA and $99 million in proposed cuts for ARC.

DEFICIT REDUCTION AND THE ECONOMY

While political and economic philosophies are at the heart of the Administration's budgetary attack on EDA, ARC, and other domestic programs, a major issue on Capitol Hill is the prospective impact of massive federal borrowing to finance the deficit between receipts and expenditures. So far, the Reagan deficits have contributed to the current economic recovery and, in conjunction with the Federal Reserve's relatively tight monetary policy, both the strong dollar and the consequent foreign trade deficit. In contrast to the "mixed blessings" of recent deficits, the future impacts of large deficits accumulating to levels over $2.2 trillion may not include beneficial side-effects. They are more likely to be higher interest rates (as federal borrowing absorbs more capital) or inflation (as debt is financed by printing more money).

Although there is little disagreement over whether federal deficits should be reduced, there are political divisions over how they should be reduced. Some argue in favor of increased revenues as well as decreased expenditures. Others are not so willing to raise taxes (distinct from fees), but disagree with placing the burden of spending reduction on domestic discretionary programs. Some feel that spending for "middle-class" entitlement programs (e.g., Social Security) must be curtailed if deficits are to be controlled, while others seek a reduction in the growth of defense spending. Yet others are calling for a true spending freeze as an equitable solution.

The House Budget Committee's analysis of the President's budget, contains the following discussion on the deficit:

> What has caused this massive increase in the deficit over the past four years? The administration has repeatedly placed the blame of these increasing deficits on "excessive government spending," and more specifically on "uncontrolled domestic spending." The administration is correct that total government spending has contributed to increasing deficits. But...during the 1981-1985 period domestic spending has not been the source of the problem. As a share of GNP, government spending has risen from 23.5 percent in 1981 to 24.6 percent under current policies in 1985, an increase of 1.1 percentage points. However, domestic spending's share of GNP has dropped from 15.7 percent in 1981 to 14.7 percent in 1985, a decline of 1.0 percentage point. By contrast, both defense spending and interest payments on the debt have increased as a share of GNP by 1.0 percentage point from 1981 to 1985. Another factor contributing to growth in the deficit has been the major loss of revenues due to the large tax cuts of 1981; revenues have declined from 20.8 percent of GNP in 1981 to 19.1 percent in 1985, a drop of 1.7 percentage points.

POLICY CHOICES FOR CONGRESS AND THE ADMINISTRATION

"For rural America, this budget is a long list of cuts without any offer of hope. It creates more problems for the small farmer, already near bankruptcy, but solves none." (From the Overview of the President's Budget prepared by the Democratic staff of the Senate Budget Committee)

The combination of the potential agricultural disaster and the documented decline in population, income and labor force in rural areas do not bode well for the future. While this decline is affecting small towns, small farmers, small businesses and small bankers, in the aggregate this decline is likely to have serious long-term consequences for the entire country. The Independent Bankers Association recently warned that the time for action on the farm problem is now and that these "small problems" can add up to a disaster. "Farm banks represent 30 percent of the nation's 14,700 banks. By year end 1984, they made up 37 percent of the 847-bank problem list (up from their 20-24 percent ranking in 1982 and 1983). There is $65-75 billion in outstanding farm belt debt owed by farmers who are leveraged over 70 percent of their total assets... We're talking at least 100,000 commercial farmers — 15 percent of the commercial farm population."

According to the Congressional Research Service, federal expenditures on agricultural and resource programs, business assistance, community facilities, veterans' housing, and native Americans favored nonmetro areas. These are the programs slated for major cuts or elimination in the President's budget. Spending on defense, space, transportation, non-veterans' housing, health and social services, employment and training and higher education favored metro areas. These programs are scheduled for increases or modest cuts or freezes. In 1980 metro areas received $2,529 per capita, while nonmetro areas received $2,139 per capita or about 10 percent less. Due to the expansion of defense programs in the budget and the

reduction in community and human resource programs, this gap may have widened in recent years.

The elected officials, businesspeople and development professionals who are working to maintain and improve the economies of small cities and rural areas have fought to maintain federal programs that are designed to help nonmetropolitan areas. NADO members have worked for the past 18 years to improve and reform federal development programs so that they will meet modern needs, but they have not been successful in convincing the current Administration of the need for such reforms. The battle of the budget since 1981 has focused solely on numbers, not on ways to improve the programs which are slated for elimination.

Although the Administration has called for elimination of EDA and most of SBA, they are going to propose that a new Administration for Enterprise Development and Opportunity be created in the Department of Commerce. This new agency would combine the small business advocacy and procurement activities of SBA with the minority business assistance programs of the Commerce Department. The preparation of such legislation could be used as an opportunity to examine the value of all federal programs which are currently helping with enterprise development, including EDA, ARC, FmHA, SBA and others.

In the last two congresses the House has passed legislation which would make significant improvements in the current programs of EDA and ARC, but the Administration has not participated in this dialogue between grassroots practitioners and members of Congress which resulted in passage of these bills. NADO recognizes the need for reform and improvement in existing development programs, and asks the Administration and the Congress to consult with practitioners from small towns and rural areas to develop improved programs.

As the current farm crisis illustrates, the parts of our economic system are interrelated and existing federal development programs work in concert at the local level, although this is not always evident to those in Washington. For example, when the SBA Sec. 503 Certified Development Company program was enacted, most of the agencies which operated this program in rural areas were existing economic development organizations. Without the "institutional infrastructure" provided by economic and local development districts, the expertise would not have existed to extend this program to small metropolitan and rural areas. If programs like EDA, ARC, FmHA, and SBA are abolished large geographical areas of the country will lose any hope of participating in the economic recovery.

EXPENDITURE TABLES

The tables on pages 7-8 list fiscal 1980-1986 funding levels for approximately 60 federal programs that have been or are of significant interest to small metropolitan and rural substate districts. Although districts have little or no role in administering most of the programs, they are of consequence for the communities and local governments served by district organizations.

The "amount change" column is the difference between the fiscal 1980 program level and the proposed fiscal 1986 level. The "percent change" column is based on the difference between the fiscal 1980 and 1986 levels. It should be noted that some programs that existed in 1980 were terminated prior to 1986 and that some programs have been created since 1980. Budget authority figures are used where available; however, many of the numbers are for the authority that was used rather than the larger amount that was available. In some cases, loan authority has been used and is indicated by brackets <>, to reflect the potential program activity.

	1980	1981	1982	1983	1984	1985	Proposed 1986	Amount Change	Percent Change
DEPARTMENT OF AGRICULTURE									
FmHA									
Water & Waste Disposal Grants	290.0	200.0	125.0	300.0	90.0	115.0	25.0	-265.0	-91.4%
Water & Waste Disposal Loans	700.0	<750.0>	<375.0>	<600.0	270.0	340.0	<50.0>	<-700.0>	-93.3%
Community Facility Loans	240.0	260.0	126.2	130.0	130.0	115.0	0.0	-240.0	-100.0%
Business & Industry Grants	10.0	5.0	0.0	0.0	0.0	0.0	0.0	-10.0	-100.0%
Business & Industry Loans	1073.0	<741.0>	<300.0>	<300.0>	<300.0>	<150.0>	0.0	-1073.0	-100.0%
Fire Protection Grants	3.5	3.5	3.3	3.3	3.3	3.3	0.0	-3.5	-100.0%
Planning Grants (Sec. 111)	6.0	5.0	0.0	0.0	0.0	0.0	0.0	-6.0	-100.0%
Rental Housing Loans	881.3	842.5	953.7	802.0	940.0	900.0	0.0	-881.3	-100.0%
Resource Cons. & Develop. (RC&D) Loans	1.8	2.0	0.9	1.2	4.0	2.0	0.0	-1.8	-100.0%
SCS									
RC & D Projects	32.0	34.0	26.5	30.7	26.0	26.0	10.0	-22.0	-68.8%
APPALACHIAN REGIONAL COMMISSION									
Area Development Programs	97.2	100.7	60.8	2.4	2.2	0.0	0.0	-97.2	-100.0%
Research, T.A., LDD	10.1	8.4	5.8	5.4	6.1	5.8	0.0	-10.1	-100.0%
Stream Clearing & Other	2.1	1.0	1.1	3.4	2.1	0.9	0.0	-2.1	-100.0%
Jobs & Private Investment	n.a.	n.a.	n.a.	33.2	29.4	40.5	0.0	-33.2	-100.0%
Distressed Counties Program	n.a.	n.a.	n.a.	14.4	14.2	14.4	0.0	-14.4	-100.0%
Health Finish-up Program	n.a.	n.a.	n.a.	4.6	5.3	7.4	0.0	-4.6	-100.0%
DEPARTMENT OF COMMERCE									
EDA									
Planning Grants	33.6	23.9	24.7	27.0	27.0	27.0	0.0	-33.6	-100.0%
Public Works	260.7	257.9	129.9	229.9	170.0	130.0	0.0	-260.7	-100.0%
Economic Adjustment Grants	85.9	12.6	33.0	33.0	33.0	33.0	0.0	-85.9	-100.0%
Technical Assistance	30.7	26.4	7.9	7.5	8.0	8.0	0.0	-30.7	-100.0%
Research & Evaluation	4.2	2.7	1.6	2.0	2.0	2.0	0.0	-4.2	-100.0%
Direct Loans	116.4	54.1	0.0	17.0	18.1	0.0	0.0	-116.4	-100.0%
Loan Guarantees	<425.0>	<425.0>	<150.0>	<20.0>	<150.0>	<150.0>	0.0	<-425.0>	-100.0%
Salaries & Expenses	40.8	39.7	25.0	27.6	27.9	20.5	14.5	-26.3	-64.5%
REGIONAL DEVELOPMENT (Title V)	109.4	47.7	0.7	0.0	0.0	0.0	0.0	-109.4	-100.0%
ENVIRONMENTAL PROTECTION AGENCY									
Construction Grants	4000.0	5100.0	3400.0	2430.0	2435.0	2400.0	2400.0	-2500.0	-51.0%
DEPARTMENT OF HEALTH AND HUMAN SERVICES									
Community Services Block Grant(1980 01 CSA)	550.5	542.3	340.3	375.1	340.0	360.1	0.0	-550.5	100.0%
National Health Service Corp.	77.5	92.3	80.4	80.3	65.3	59.7	50.0	-27.5	-35.5%
Rural Development Loan Fund	20.0	7.7	0.0	0.0	10.0	0.0	0.0	-20.0	100.0%
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT									
Comm. Dev. Block Grant (CDBG)(30% rural)	3062.0	3694.6	3456.0	4456.0	3468.0	3468.0	3124.8	737.2	19.1%
Urban Dev. Action Grant (UDAG)(25% rural)	675.0	675.0	473.7	440.0	440.0	440.0	0.0	-675.0	-100.0%
Rehabilitation Loans (312)	214.2	132.3	49.9	44.9	132.1	0.0	0.0	-214.2	-100.0%

	1980	1981	1982	1983	1984	1985	Proposed 1986	Amount Change	Percent Change
DEPARTMENT OF INTERIOR									
State Outdoor Rec. (LWCF) Grants	318.6	293.5	46.4	112.2	115.2	102.4	0.0	-318.6	-100.0%
State Historic Preservation Grants	43.8	51.7	23.3	46.9	22.0	21.1	0.0	-43.8	-100.0%
Payment in Lieu of Taxes	108.0	108.0	91.3	96.1	105.0	102.9	105.0	-3.0	-2.8%
DEPARTMENT OF LABOR									
JTPA State Block Grant (1980 CETA)	3342.0	n.a.	n.a	2179.3	3300.0	1886.2	1886.2	-1455.8	-43.6%
Summer Youth (1980 CETA)	2330.5	n.a.	n.a	824.2	824.5	824.5	724.5	-1606.0	-68.9%
Dislocated Worker (1980 Trade Adj. Asst.)	1664.4	n.a.	n.a	110.0	262.7	235.3	123.0	-1541.4	92.6%
Comm. Service Empl. for Older Amer.	266.9	277.1	282.0	319.5	317.3	326.0	326.0	59.1	22.1%
SMALL BUSINESS ADMINISTRATION									
503 Cert. Development Co. Loans	<250.0>	<100.0>	<150.0>	<250.0>	<350.0>	<450.0>	0.0	<-250.0>	-100.0%
Small Bus. Investment Co. Loans	146.8	160.0	134.1	159.9	250.0	256.0	0.0	-146.8	-100.0%
Minority Ent. SBIC Loan (Direct)	32.5	41.2	27.3	25.7	41.0	41.0	0.0	-32.5	-100.0%
General Business Loans (Guaranteed)	<3000.0>	2804.7	1516.5	2094.4	2600.0	2660.6	0.0	<-3000.0>	-100.0%
General Business Loans (Direct)	218.7	205.1	114.8	85.5	108.3	108.8	0.0	-218.7	-100.0%
Handicapped Loans(Guaranteed)	8.3	1.7	0.8	1.6	5.0	5.0	0.0	-8.3	-100.0%
Handicapped Loans (Direct)	19.9	25.0	13.1	14.9	20.0	24.0	0.0	-19.9	-100.0%
Economic Opportunity Loans (Guaranteed)	24.5	20.4	13.4	30.5	60.0	60.0	0.0	-24.5	-100.0%
Economic Opportunity Loans (Direct)	63.2	49.0	21.8	16.5	45.0	45.0	0.0	-63.2	-100.0%
Energy Loans (Guaranteed)	11.3	7.3	1.3	3.2	15.0	15.0	0.0	-11.3	-100.0%
Energy Loans (Direct)	14.4	6.7	1.2	0.4	3.0	0.0	0.0	-14.4	-100.0%
Veterans Loans (Direct)	0.0	0.0	0.0	6.4	25.0	25.0	0.0	0.0	-100.0%
Management Assistance	22.1	19.5	29.4	33.1	39.5	39.1	0.0	-22.1	-100.0%
Sec. 501 Program	0.0	0.0	0.0	0.0	2.0	5.0	0.0	0.0	-100.0%
SBIC Program	3.9	8.1	11.6	15.4	28.5	28.5	0.0	-3.9	-100.0%
Sec. 502 Dev. Company Loans (Direct)	44.7	6.0	0.0	0.0	0.0	0.0	0.0	-44.7	-100.0%
TENNESSEE VALLEY AUTHORITY									
Economic & Comm. Resources	12.4	11.2	16.8	18.1	20.8	22.5	0.0	-12.4	-100.0%
DEPARTMENT OF TRANSPORTATION									
Local Rail Service Assistance	82.6	47.4	28.0	22.0	25.2	29.2	5.7	-76.9	-93.1%
Sec. 18 Mass Transit Grants (100 % rural)	57.1	73.2	74.3	77.2	79.2	81.5	32.2	-24.9	-43.6%
Aircraft Purchase Loans	<650.0>	429.0	201.5	102.5	0.7	0.0	0.0	<-650.0>	-100.0%
Appalachian Highway Systems	228.7	218.2	107.6	116.1	110.8	104.3	0.0	-228.7	-100.0%
Secondary (Rural) Highway System	772.9	443.1	287.0	602.3	500.0	500.0	500.0	-272.9	-35.3%
Payments to Air Carriers(Local Air Service)	95.8	114.5	86.1	52.1	46.3	46.3	0.0	-95.8	-100.0%
DEPARTMENT OF TREASURY									
General Revenue Sharing	6854.9	4569.9	4566.7	4566.7	4566.7	4566.7	0.0	-6854.9	-100.0%

NOTES. (1) Brackets <> indicate Loan Guarantee Authority (e.g., EDA Loan Guarantees)
(2) n.a. indicates not applicable or not available.
(3) The Comprehensive Employment and Training Act preceeded JTPA.

Ms. Wohlbruck. I won't go through all our comments on the President's budget, but I would like to just make one comment. If it's rural, it's been cut, and I think that our charts in the back of the report make this point. I notice your staff member is reading "Small Is Beautiful." In our opinion in this budget, small is expendable; and all the programs that are designed to help small towns, small business, small farmers, small banks seem to be listed for elimination. And that's in addition to the enormous cuts in the farm programs.

We have 2 pages of charts that list the programs that we think are most important for small town economic and business development. That includes the Economic Development Administration, the Appalachian Regional Commission, the Farmers Home Administration, and the Small Business Administration. EDA, ARC, and SBA would be eliminated, along with the business and industry and community facilities programs of Farmers Home, plus Farmers Home water and sewer programs would be drastically reduced.

We've been asked what the total rural cuts are, but unfortunately we cannot come up with an accurate total. Like many other statistics on rural or nonmetropolitan areas, reliable numbers are not readily available even though there is a law, the Rural Development Policy Act, which requires that a rural budget analysis is to be prepared annually. This has never been done, and that law was passed in 1980.

Mr. Chairman, the latest USDA analysis clearly shows that the general economic recovery of the past 2 years has bypassed many rural areas. The prolonged economic recession beginning in 1980 has retarded rural economic growth and diminished the ability of rural areas to retain, let alone attract, people. While metropolitan population has continued to grow at the same rate as during the 1970's, the growth rate for nonmetropolitan areas has fallen to about 60 percent of that enjoyed during the past decade. This is largely due to the greater severity of the economic recession in small towns and rural areas. USDA's Economic Research Service has pointed out that unemployment, discouraged workers, and involuntary shifts from full-time to part-time work schedules all increased more rapidly among nonmetropolitan residents than those in metropolitan areas. Rural unemployment is, has been, and continues to be higher than it is in metropolitan areas.

The financial problems of many farmers and liquidity problems of small rural banks are now receiving significant publicity. Many of these troubled financial institutions are in no position to provide adequate credit on affordable terms to local nonfarm businesses. They are faced with substantial losses on existing farm loans that could impair their capital and lead to closure. For rural small businesses, already confronted with historically high real interest rates on commercial loans, elimination of more favorable alternative sources of debt financing is likely to spell disaster—you've heard about that from your previous witnesses—those unable to obtain or afford bank loans almost surely will go under, and others could face higher borrowing costs without the influence on rates exerted by the availability of Federal credit assistance.

The economies of small cities and their surrounding rural areas are based on small business, and the tax bases of these local gov-

ernments are dependent on small business. In most of the small towns and counties in rural areas, there is virtually no business but small business. And Bill Folkerts from Watertown just told me yesterday how the sales tax revenue numbers that you quoted are affecting small towns in his region. For the third consecutive year, the sales tax receipts are going down in those small towns.

As the current farm crisis illustrates, the parts of our economic system are interrelated and existing Federal development programs work in concert at the local level, although this is not always evident to those people here in Washington. For example, most of the SBA Section 503 Certified Development Companies, operating in rural areas, were organized by existing economic development organizations. Without this institutional infrastructure that programs like EDA have supported there would be no expertise available to extend these programs to small towns and rural areas. If programs like EDA, ARC, Farmers Home, and SBA are abolished, large geographical areas of the country will lose any hope of participating in the economic recovery. The combination of the potential agricultural disaster and the documented decline in population, income, and labor force in rural areas do not bode well for the future. While this decline is affecting small towns, small farmers, small business, and small bankers, in the aggregate we believe this will have serious long-term consequences for the entire country.

I have been reminded that the last depression started down on the farm, but that it didn't stay there. People have asked us, as rural citizens, what do we want, and I would like to read a statement that I think sums up our policy:

> Whether farmers or not, all rural citizens should have the same consideration as those who live in towns and cities in economic development, energy, credit, transportation availability, and employment. Opportunities for non-farm jobs have become increasingly important to farm and ranch families, enhancing life and work in rural America.

This is from the 1984 Republican National Platform.

In addition, our board of directors, when they were in town last week—they are local elected officials and economic development professionals and businesspeople from small towns—adopted a resolution calling for a freeze on all programs in the Federal budget for fiscal 1986 and reform of the development programs that are scheduled for elimination in the President's budget.

NADO urges the Congress and the administration to come to quick agreement on a budget freeze so that at the local level, development agencies and local governments can get on with their activities which we think are contributing to the current economic recover.

Thank you again, Mr. Pressler, for inviting us to testify and I'd be happy to answer questions.

[The prepared statement of Ms. Wohlbruck follows:]

STATEMENT BY ALICEANN WOHLBRUCK, EXECUTIVE DIRECTOR, ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS, BEFORE THE SUBCOMMITTEE ON SMALL BUSINESS: FAMILY FARM, U.S. SENATE, FEBRUARY 27, 1985.

INTRODUCTION

Mr. Chairman, members of the Subcommittee on Small Business: Family Farm, I am Aliceann Wohlbruck, Executive Director of the National Association of Development Organizations (NADO). I am submitting this testimony on behalf of NADO's members whose primary focus is on creating private sector jobs in rural areas and small towns. The members of our association are eager to work with the Congress to shape small business, agriculture and rural development policies that will benefit farmers, rural residents and local governments that serve them.

NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

NADO was founded in 1967 by a group of economic development districts to encourage the creation and retention of jobs in rural areas and small communities. Today our members are multi-county planning and development organizations and other state and local agencies which help local governments and the private sector to work together.

THE 1986 BUDGET - WHAT DOES IT MEAN FOR RURAL DEVELOPMENT?

Last week, NADO released an issue paper, The 1986 Budget - What Does It Mean for the Development of Rural Areas and Small Cities? I am submitting this report with my brief testimony and ask that it be made part of the hearing record, because it contains information about the current rural economic situation.

Our goal in appearing before you today is to reenforce your concern for the needs of the one-third of the U.S. population who live in rural areas. Of these 82 million citizens, only 2.2 million, or 2.7 percent, are directly employed on farms, but many of the rest depend upon agriculture, forestry, or fisheries for part of their income. On the other side of the coin, many farmers depend upon off-farm income for an adequate total income. We believe it is important for this Subcommittee to be supportive of the needs of all these rural people for jobs, housing, community facilities, and government services. While there is a Department of Housing and Urban Development there is no Department of Rural Development. Those of us who serve rural citizens often have a hard time being heard in the Halls of Congress and at the White House when we point out development needs in rural areas. Rural is often believed to be the same as agricultural and to some it seems improper to put rural and development together.

RURAL ECONOMIC DEPRESSION

The general economic recovery of the past two years has bypassed many rural areas. The prolonged economic recession beginning in 1980 has retarded rural economic growth and diminished the ability of rural areas to retain, let alone attract, people. While metropolitan population has continued to grow at the same rate as during the 1970s, the growth rate for nonmetropolitan areas has fallen to about 60 percent of that enjoyed during the past decade, largely due to the greater severity of the economic recession in small towns and rural areas. As pointed out by USDA's Economic Research Service, "Unemployment, discouraged workers, and involuntary shifts from full-time to part-time work schedules all increased more rapidly among nonmetropolitan residents than those in metropolitan areas."

The nonmetropolitan economy has failed to perform as well as the metropolitan economy during the 1980s. Not only have there been problems in the agricultural sector, but also many of the nonfarm industries in rural America are mature, slow-growth industries that tend to relocate to low-wage locations such as Third World countries. One result is that by 1982 the nonmetropolitan unemployment rate exceeded the metropolitan rate by two percentage points, and our research shows that the rural rate was still above the national average in mid-1984.

Another result is that in 1983 the nonmetropolitan median family income was only $20,938, while the metropolitan median income was $26,488 (27 percent higher). In fact, while the metropolitan median increased by 17.3 percent between 1980 and 1983, the nonmetropolitan median increased only 15.9 percent (while the Consumer Price Index rose by 20.9 percent). One effect of this was that the nonmetropolitan poverty rate increased from 15.7 percent in 1980 to 18.3 percent in 1983.

Rural America includes virtually all of the areas of severe and prolonged poverty. All of the counties that have had consistently low incomes since 1960 are nonmetropolitan. In short, rural America is the home of an economic underclass.

As the Subcommittee considers the future, we ask that you keep the following facts in mind about rural areas:

Over-Specialization by Economic Sector - Rural areas are often more dependent upon one or two economic activities for the majority of employment. Dominant activities vary from one area to another. Mining, agriculture, forestry, fishing and tourism are the usual major employers.

Isolation - Rural areas are often more physically and culturally isolated from major markets. Rural manufacturing firms are often not as aware of changes in buying habits as firms closer to major consumer areas.

Transportation - Many rural areas lack the air, rail and highway facilities to attract and hold business. Adequate transportation facilities are not only absent in many rural areas, but others such as secondary highways and bridges are poorly maintained due to a lack of funds.

Unemployed Are Exported - Unemployment figures for rural areas not only are statistically unreliable, but also are often misleading because the unemployed leave the labor force, if not the area, after a period of unsuccessful job searching. Youth outmigration is still a problem.

Small Community Tax Bases Makes Debt Financing Difficult - Rural communities often lack the ability to finance public facilities to attract businesses on their own. The small population and tax base of many rural communities effectively prohibits any expansion of existing publicly-owned utilities without outside help. At the same time, in many small towns the local banks have been selling, not buying, tax-exempt bonds, because changes in the tax laws make these bonds less attractive to small institutions. Yet, the congress has approved, with the support of the Administration, further restrictions on the issuance of Industrial Development Bonds which have been the only way for many rural governments to compete for development with big cities (which have a much larger tax bases and more resources to attract new development.)

Rural Areas Lack Capital Markets - A 1981 study done for the U.S. Department of Commerce reported that the unmet capital demand is highest in rural areas; small firms have the most difficulty obtaining capital; and independent firms are at a disadvantage in capital markets. For both the farmer and the small business person in rural America, the availability and cost of borrowing money is a major problem. The transformation of American lending institutions is having a profound effect on rural areas. Until recently rural businesses could count on doing business with their local bank which was safely isolated from the vicissitudes of international money markets. For rural banks, the cost of funds was often below the prime rate. This is no longer the case and rural businesses and farmers pay interest rates the same as or higher than urban entrepeneurs.

Historic Demand Shows Greater Need in Rural Areas for Basic Facilities Aid - Rural areas have historically sought different types of federal assistance than urban areas. Nonmetropolitan areas have tended to receive more per capita in community facilities assistance, in business and industrial development and in natural resources outlays than urban areas. Urban areas have tended to receive more per capita in defense contracts, in housing and in transportation spending.

Poverty Indicators Higher for Rural Areas - The incidence of poverty is significantly higher in rural areas -- at least 35 per cent of the nation's poor are in rural areas. Rural people experience poorer health than urban dwellers and there is a shortage of medical services in rural areas. The incidence of substandard housing is three times higher in rural than in urban areas. Per capita income in rural areas continues to lag substantially behind the national average.

Farmers Face Financial Problems - The cost of money has risen faster than any other item in the production of crops, and many farmers are facing a serious problem because they have excessive debt loads. In the 1970's some farmers were able to survive economically by increasing their debt load by borrowing against their increasing land values. When land values began to decline in 1980 a large group of farmers (perhaps as many as ten percent) were burdened with excessive debt loads and are vulnerable to bankruptcy. In many rural areas these bankruptcies will have a very detrimental effect on local economies. The value of farm land already has eroded local tax bases which depend heavily on real property taxes.

WHY SHOULD THE URBAN MAJORITY CARE ABOUT THE RURAL MINORITY?

The financial problems of many farmers and the consequent liquidity problems of small, rural banks have been given significant publicity of late. Clearly, many of those troubled financial institutions are in no position to provide adequate credit on affordable terms to local non-farm businesses. Rather, they are faced with substantial losses on existing farm loans that could impair their capital and lead to their closure.

For rural small businesses already confronted with historically high real interest rates on commercial loans, elimination of more favorable, alternative sources of debt financing is likely to spell disaster in one form or another. Those unable to obtain or afford bank loans almost surely will go under and others could face even higher borrowing costs in the absence of the influence on rates exerted by the availability of federal credit assistance.

The Independent Bankers Association of America which represents small, mostly rural, banks recently reminded Congress of the inter-relationship of the various contributors to the rural economy:

> While only three percent of the population is directly involved in agriculture, 20 percent is dependent on ag-related industries. Consumers as a whole have long enjoyed a cheap food policy. If you permit agriculture to continue to deteriorate and producers to continue to fail, food will necessarily be more expensive. The ag bank does not operate in a vacuum. It is a building block of the community — often the only financial institution in the community. If it goes, the school and Main Street are next.

Congress and the American people should understand the consequences before they follow the lead of the administration's "anti-subsidy" rhetoric in the name of deficit reduction. Good public policy cannot be made in the absence of open, informed deliberation — a complex budget reconciliation bill rammed through quickly may be politically expedient for those who craft the bill, but it is not likely to yield equitable treatment for those affected, particularly the rural minority.

THE FEDERAL RESPONSIBILITY

The federal responsibility for promoting the economic welfare of the nation is little disputed. Differences arise as to the extent of responsibility and the methods to be employed in meeting these obligations.

We believe that the federal government has a responsibility to encourage, in fact to foster, economic development in rural and urban areas. Not all communities are equally endowed with economic resources and the effects of broad macro-economic policies do not fall evenly across the land. In fact, we see an abundance of cases in which federal policies benefit the economies of a few relatively affluent communities at a cost to others which have higher unemployment and lower household incomes. (For example, the procurement of major weapons systems is limited to a few firms in wealthy urban areas.)

While we do not seek more than an equitable share for rural areas for development programs, we believe that the programs which help the most rural (the "truly rural" if you will) areas to become economically self-sufficient have taken a disproportionate share of budget cuts during the last four years. For the fifth consecutive year, the Administration has proposed a package of funding cuts which would adversely affect rural economic development. The 1986 Budget proposes the following:

* Eliminate the Economic Development Administration and the Appalachian Regional Commission
* Eliminate the Small Business Administration
* Eliminate the Business and Industry and Community Facilities Programs of the Farmers Home Administration
* Reduce by over 90 percent the Water and Sewer Programs of FmHA
* Eliminate rural housing programs
* Phase out all Rural Electrification and telephone loan programs
* End rural transportation operating assistance

According to the Congressional Research Service, federal expenditures on agricultural and resource programs, business assistance, community facilities, veterans' housing, and native Americans favored nonmetro areas. These are the programs slated for major cuts or elimination in the President's budget. Spending on defense, space, transportation, non-veterans' housing, health and social services, employment and training and higher education favored metro areas. These programs are scheduled for increases or modest cuts or freezes. In 1980 metro areas received $2,529 per capita, while nonmetro areas received $2,139 per capita or about 10 percent less. Due to the expansion of defense programs in the budget and the reduction in community and human resource programs, this gap may have widened in recent years.

If these budget proposals are accepted by Congress, rural communities could no longer rely on the federal government for needed economic development assistance. And, contrary to President Reagan's opinion, few state governments are fiscally able to fill the gap. The result would be a ripple effect since the federal programs tend to be closely linked with private sector investment. In short, program terminations and reductions in funding would effectively decrease the rate of growth in some rural areas and accelerate economic decline and consequent population loss in others.

Federal programs to stimulate rural development have been cut significantly during the past five years. Prior to the 1983 Jobs bill, FmHA rural development programs had been cut by nearly 78 percent. Federal funds for urban development have had much smaller reductions, and are again scheduled for a smaller reduction in the 1986 budget.

ELIMINATING SMALL PROGRAMS - DO THEY MATTER?

In the debate about big budget cuts and big deficits, the problems of small towns and small businesses that small federal programs are designed to help are in danger of being ignored. Programs like the Economic Development Administration (EDA), Appalachian Regional Commission (ARC), Farmers Home Administration (FmHA) and the Small Business Administration (SBA) have helped thousands of companies and localities to create private sector jobs.

The economies of small cities and their surrounding rural areas are based on small business and the tax bases of these local governments are dependent on small business. In most of the small towns and counties in rural areas there is virtually no business but small business.

Some years ago there was a book called Small Is Beautiful. In the President's budget, small is expendable.

As the current farm crisis illustrates, the parts of our economic system are interrelated and existing federal development programs work in concert at the local level, although this is not always evident to those in Washington. For example, since the SBA Sec. 503 Certified Development Company program has been enacted, most of the agencies operating this program in rural areas have been existing economic development organizations. Without the "institutional infrastructure" provided by economic and local development districts, the expertise would not have existed to extend this program to small metropolitan and rural areas. If programs like EDA, ARC, FmHA, and SBA are abolished large geographical areas of the country will lose any hope of participating in the economic recovery.

The elected officials, businesspeople and development professionals who are working to maintain and improve the economies of small cities and rural areas have fought to maintain federal programs that are designed to help nonmetropolitan areas. NADO members have worked for the past 18 years to improve and reform federal

development programs so that they will meet modern needs, but they have not been successful in convincing the current Administration of the need for such reforms. The battle of the budget since 1981 has focused solely on numbers, not on ways to improve the programs which are slated for elimination.

The combination of the potential agricultural disaster and the documented decline in population, income and labor force in rural areas do not bode well for the future. While this decline is affecting small towns, small farmers, small businesses and small bankers, in the aggregate this decline is likely to have serious long-term consequences for the entire country.

The Overview of the President's Budget prepared by the minority staff of the Senate Budget Committee contains this statement:

"For rural America, this budget is a long list of cuts without any offer of hope. It creates more problems for the small farmer, already near bankruptcy, but solves none."

WHAT DO RURAL CITIZENS WANT?

> Whether farmers or not, all rural citizens should have the same consideration as those who live in towns and cities in economic development, energy, credit, transportation availability and employment. Opportunities for non-farm jobs have become increasingly important to farm and ranch families, enhancing life and work in rural America. (Emphasis added)
> -- 1984 Republican National Convention Platform

RURAL DEVELOPMENT ORGANIZATIONS SUPPORT BUDGET FREEZE AND PROGRAM REFORM

The National Association of Development Organizations' (NADO) Board of Directors adopted a resolution at their February 21 meeting calling for a freeze on all programs in the federal budget for fiscal 1986, and reform of the development programs scheduled for elimination in the President's budget.

NADO's members urge the Congress and the Administration to come to quick agreement on a budget freeze, so that local development agencies and local governments can get on with their activities which are contributing to the current economic recovery.

Senator PRESSLER. Mr. Mullenholz. Am I saying it correctly?

Mr. MULLENHOLZ. That's correct, Mr. Chairman. It shows your good German background.

Senator PRESSLER. Great.

STATEMENT OF JOHN J. MULLENHOLZ, LAW FIRM OF NEAL, MULLENHOLZ, SHAW & SEEGER, REPRESENTING THE NATIONAL FARM & POWER EQUIPMENT DEALERS ASSOCIATION

Mr. MULLENHOLZ. Mr. Chairman, I've put together about a seven-page statement that I'd like to submit for the record, and I'd like to summarize the first part of it. Much of it would be repetitious of what has been said by the earlier panel.

I would, however, like to read the second part of it because it deals with a survey that we made among our members which I think you'll find interesting.

Senator PRESSLER. I think that's very important, and pull that microphone right up so that everybody can hear.

Mr. MULLENHOLZ. Thank you, Mr. Chairman.

First of all, I'd like to thank you for giving us the opportunity to appear and make our position known here today. I regret that we do not have any members of our executive committee here to appear before you and perhaps give you more firsthand experience; however, there's a reason for that. Early on we recognized the current credit crisis that is in the agricultural committee, and we had 25 dealers here in Washington in January meeting with congressional leaders and leaders of the U.S. Department of Agriculture to encourage them to try to get money to these farmers in order to permit them to get their crops in the ground. As with the other input industries that have been represented here today, we have firsthand knowledge of these credit problems that these farmers feel and we recognize the fact that many of them were not going to be able to plant unless some action was taken. And so our members came here early in January to try to get the Government moving in that regard, and we're gratified to see that some effort is being made at the present time.

I guess our major concern, outside of the actual purchasing of equipment, is for the ability of the farmer who is a good farmer, who is a solid producer, who is a good manager, who is unable to get the credit he was able to obtain in the past. In previous days those farmers could walk into a bank and just on their reputation be able to get a loan; not necessary to put their crop in the ground. That's no longer true. The reason for that, I think, is manyfold. Not only is it the question of the decreasing land prices and high interest rates and the lack of liquidity on the part of the farmer, but the banks themselves have experienced a great change in the way that they're operating. And I know this because I'm an attorney and many of the dealers have come to me for advice, and those dealers sit on the boards of some of these banks. They've been hurt badly. As you know, when these banks go under, the directors 'and the officers 'funds that are in those banks are frozen, and frequently suits are brought against those directors and against those officers who have engaged in traditional lending practices, who have tried to work with the farming community; and as a result of their

doing so, have found themselves the target of lawsuits to try to recover funds.

This has created a crisis in the banking community, in those rural banks where the banks are no longer looking at the farmer; they're looking at his balance sheet, and cold, hard facts are what determines whether a farmer is going to get a loan in this day and age.

If something can be done in this regard for those rural banks, if the Government can ease the manner in which they are going to be looking at these loans, then I think the farmers are going to be able to get more credit. Some of the programs that have been proposed—forgiveness of 10 percent of the principal, 10 percent of the interest—are fine, but the banks can't afford to do that frequently. And it's wonderful to say that the Government will come in and guarantee 90 percent if the other 10 percent's forgiven, but our members who sit on those bank boards say that the banks can't afford to give up 10 percent.

So in general, in terms of the credit crisis that is out there today, our members feel that it is incumbent upon the Government to try to protect those good producers, those good managers, in order that they will continue to be with us for the next 5 or 10 years and not find themselves in the position that those who got into the business 5 or 10 years ago are in today.

Addressing for a moment Senator Dixon's remark about the 8 to 9 percent who owe about a third of the $210 billion that is outstanding in credit today, I've seen those same statistics. Those individuals owe somewhere in the neighborhood of $63 billion, and it is estimated that they are not even going to be able to meet their interest payments, let alone repay the loans. I think if this committee is looking for something that it can do in this time of a credit crisis, it should look to those who are owed the $63 billion. What are we going to do with those? Those are the dealers, those are the equipment dealers and the other input industries, the banks, who are going to lose $63 billion when these farmers go under. And I think some concern needs to be paid in that regard. The plight of the farmer—it is dramatic. What isn't heard, for example, on a regular basis is how many equipment dealers have gone out of business, how many jobs have been lost in the equipment industry. I heard a figure the other day that over the last couple of years, 18,000 jobs have been lost in the farm equipment industry; and yet, that is something that we are not looking at. We are looking at other causes, but we're not looking at remedying some of the hardships that have been created in our own industries, the input industries.

Let me for a moment, Mr. Chairman, just read from my statement concerning our survey.

In July '1984, a questionnaire was mailed to better than 9,000 farm equipment dealers who were doing business in the United States and Canada. Almost 25 percent of the dealers responded and the information which they provided gives us a solid basis of data from which to draw a profile of the typical North American farm equipment dealer.

Better than 75 percent of the dealerships are owned by sole proprietors or family-owned corporations and partnerships.

And I think an interesting thing about this survey is how it shows that the farm equipment dealer really mirrors the farmer, where we have a sole proprietor, family-owned, second and third generation ownership of these operations.

About 42 percent of the dealerships are owned by a second or third generation of the founding family. A significant portion of the dealers, almost 30 percent, are relatively young—between the ages of 36 and 45.

The general financial condition of the dealer mirrors that of the farmer according to the survey. Slightly better than half, 57 percent, of the responding dealers are profitable, and the reasons given for profitability by those dealers can be reduced to one common denominator, sound management practices.

Diverting from our survey for a moment, I find as I talk to dealers throughout the nation that they are painfully aware of the problems which the farmers are facing. They are quick to add that those farmers who exercise proper management of their operations are the ones who are succeeding today. They also note that many of those in trouble are themselves responsible for their plight as opposed to being victims of circumstances.

Among the dealers who are not making a profit, high interest rates, low sales, and competition are the major factors noted.

Looking to the future, almost 30 percent of the dealers took a pessimistic attitude. In many ways the outlook of the dealers tracks the demographics of the producers. Our members foresee fewer and larger dealerships in the coming years. The same is true of the farm itself. For the latest year in which statistics are available, USDA shows that 13 percent of the farms produced almost 75 percent of the cash receipts. That means that 87 percent of the farmers are outside of the mainstream of agricultural production in North America. It also means that income necessary to purchase equipment is not available to the overwhelming majority of the farmers.

Based upon USDA statistics as to the number of farms with real purchasing power and our own internal estimates as to the number of farms which one dealer can service, we have reached the conclusion that there are only 5,000 dealers needed in the United States today. There are, however, 8,800 dealers in the U.S., giving us an excess capacity of 3,800 dealers, or 43 percent.

As a result, we find that dealers are taking steps to expand into other areas, such as lawn and garden or industrial equipment. They are adding, or considering adding, new tractor lines in order to become more competitive. Dealers are convinced that the "good old days" of the 70's are gone, and that they are gone forever, and that we are in a time of survival of the fittest.

Like farming, our industry is in transition. We do not mean to imply that 43 percent of the dealers will go out of business, nor is our Association willing to simply write them off. Rather, having analyzed the current conditions, we intend to work with them to meet the challenges of a shrinking market in order to preserve the best possible dealer base to serve our customers, the farmers.

And I'll stop quoting.

In closing, Mr. Chairman, we appreciate the opportunity to be here. I think one significant thing that should be noted by the committee, and we've made this known to others that we've met with on the Hill, is that for the first time in many years, and perhaps in the history of the Dealer Association, the executive committees of both the dealers' and the manufacturers' associations have resolved to take an active role in the formulation of the farm bill. This is a dramatic departure from past practice; in fact, it has always been the position that because you were bound to alienate one of your customers if you supported a program that another one liked, the dealers as well as the manufacturers have always refused to take any active role in the farm bill. That is not the case in this current legislative session, and you will be hearing more from the dealers, you will be seeing more of them here on the Hill—you, yourself, have a very active association out in South Dakota, politically active, as well as active in terms of trying to help the State come to grips with this farm problem. It's headquartered, as you probably

know, in Minneapolis, but it works very, very actively out in your State.

And again I regret that Mr. Kenny Austin, who is the executive director of that association, and some of the South Dakota dealers couldn't be here today. They asked me to send their regards and to thank you for giving us this opportunity.

[The prepared statement of Mr. Mullenholz follows:]

National Farm & Power Equipment Dealers Association

JOHN J. MULLENHOLZ
Legislative Director

UNITED STATES SENATE

SMALL BUSINESS COMMITTEE

SUBCOMMITTEE ON FAMILY FARM

WASHINGTON, D.C.

FEBRUARY 27, 1985

Mr. Chairman and members of the Subcommittee my name is John Mullenholz and I am the Legislative Director of the National Farm & Power Equipment Dealers Association. Our association represents the more than 9,000 farm implement dealers throughout the United States and Canada who sell and service the equipment which keeps our farms operating today.

In order to try to give this subcommittee as complete a picture as possible in the short time available, we would like to touch briefly on a number of factors which we believe are contributing to the credit crisis in the agricultural industry today. We will then give the results of a survey which we took recently of our membership. In the 1970's, the American farmer could see unlimited prosperity down the road. A combination of government programs and foreign demand for U.S. agricultural products provided a market, or at least a source of income, for almost everything that a farmer could produce.

However, a confluence of factors in the early 1980's has reversed the expectations of the American farmer. The grain embargo caused a restructuring of international markets for our agricultural products. Many foreign producers began competing with U.S. agriculture on a favorable basis. The results of years of research and assistance from the U.S. to farmers in lesser-developed countries started to bear fruit as those who were our customers became our competitors.

High interest rates and declining inflation had a devastating impact on farmers who were encouraged to expand their operations. A reduction in federal support programs created difficulties for those farmers who had expanded, as well as those who began farming operations during the halcyon days of the mid to late '70's.

Since the farmers are our customers, generally speaking, the dealers have been faced with the same economic conditions. It goes without saying that if your customers are financially depressed, you are going to lose sales which you would have made in better times.

Although we have no statistics to support this conclusion, because we deal in durable goods we have probably experienced more difficulty than the other so-called "input" agricultural businesses such as seed and fertilizer. The farmer is quite capable of keeping a tractor or other piece of equipment in repair for an extended period of time when the money is not available to purchase a newer, more powerful and more

productive replacement. The farmer is not unlike any other consumer in this regard. When the automotive industry was suffering a few years ago, the average age of an automobile on the road was constantly increasing.

Presumably, the question in which this subcommittee is interested, is whether the current credit crisis has affected the implement dealers. The answer to this is generally "yes," but indirectly. The farmer, to the extent that he can qualify for credit, can purchase equipment through the financing divisions of the major manufacturers. He is not limited to the traditional sources such as banks, PCAs, FmHA, which have restricted the amount of credit available to the farmer. On the other hand, the farmer's financial condition itself can be, and frequently is, a limiting factor in acquiring credit from a manufacturer's financing company. The analysts in these companies look at the same criteria as banks and other lending institutions and will probably reach the same conclusion with respect to a particular farmer.

There is, however, a difference in the current practices of the more traditional lenders versus that of the manufacturers. On the one hand, government programs have not provided as much funding and have not had the personnel necessary to process the loan applications thereby limiting access to funds. Many rural banks, on the other hand, have closed or have been rated by Federal and state agencies as problem banks. This has created a shortfall of commercial lending activity. Just as importantly, the small independent banks have become

extremely cautious in their lending attitudes. They are examining the farmers' financial statement very closely and they are making loans on cold hard facts rather than the reputation of the borrower.

This attitude is understandable in light of the exposure which many officers and directors have faced as a result of bank failures. Many of our dealers sit on bank boards and some of them have first-hand experience with the problems that result when a bank closes its doors. Nevertheless, the attitude of the banks is a drastic departure from times past.

While it is important that the Federal government deal with the immediate credit crisis which faces the farmer today, it is just as important that it consider the long-term outlook. In this regard we would like to give you that view through the eyes of the dealers. Information has been compiled from more than 2,000 dealers in response to a survey which our National Association made last year. In July, 1984, a four-page questionnaire was mailed to 9,107 farmer equipment dealer-members of NFPEDA doing business in the U.S. and Canada. Almost 25% of those dealers responded and the information which they provided gives a solid base of data from which to draw a profile of the typical North American farm equipment dealership.

Better than 75% of the dealerships are owned by sole proprietors or family-owned corporations and partnerships. About 42% of the dealerships are operated by a second or third

generation of the founding family. A significant portion of the dealers, almost 30%, are relatively young--between the ages of 36 and 45. The importance of these statistics is that the dealer, like his customer the farmer, operates his business through his family and family members continue to hold the business over the years.

The general financial condition of the dealer mirrors that of the farmer according to the survey. Slightly better than half, 57%, of the responding dealers are profitable and the reasons given for profitability by those dealers can be reduced to one common denominator "sound management practices." Diverting from our survey for a moment, I find as I talk to dealers throughout the nation that they are painfully aware of the problems which the farmers are facing. They are quick to add that those farmers who exercise proper management of their operations are the ones who are succeeding. They also note that many of those in trouble are themselves responsible for their plight as opposed to being victims of circumstances.

Among the dealers who are not making a profit, high interest rates, low sales and competition are the major factors noted.

Looking to the future, almost 30% of the dealers took a pessimistic attitude. In many ways the outlook of the dealers tracks the demographics of the producers. Our members foresee fewer and larger dealerships in the coming years. The same is true of the farm itself. For the latest year in which

statistics are available, USDA shows that 13% of the farms produced almost 75% of the cash receipts. That means that 87% of the farmers are outside of the main stream of agricultural production in North America. It also means that the income necessary to purchase equipment is not available to the overwhelming majority of the farmers.

Based upon USDA statistics as to the number of farms with real purchasing power and our own internal estimates as to the number of farms which one dealer can service, we have reached the conclusion that there are only 5,000 dealers needed in the United States. Today, however, there are 8,800 dealers giving us an excess capacity of 3,800 or 43% of existing U.S. dealers.

As a result, we find the dealers taking steps to expand into other areas such as lawn and garden or industrial equipment. They are adding or are considering adding new tractor lines in order to become more competitive. Dealers are convinced that the "good old days" of the 70's are gone forever and that we are in a time of survival of the fittest.

Like farming, our industry is in transition. We do not mean to imply that 43% of the dealers will go out of business. Nor is NFPEDA willing to simply write them off. Rather, having analyzed the current conditions, we intend to work with them to meet the challenges of a shrinking market in order to preserve the best possible dealer base to serve our customers, the farmers.

In closing Mr. Chairman we want to thank you for this opportunity to appear and hope that we can provide any additional information which you might seek. To emphasize the importance of what you are doing here today and what the Congress will be doing in the coming months, we want you to be aware of how significant the legislative process is to the dealers. The single most important activity of the National Association according to the responding dealers was legislative activity.

A significant number of dealers pointed to the need of farmers for a spokesman and for a public relations program to educate the general public on the worsening plight of the farmer. For the first time in many years, perhaps in the entire history of our Association, the dealers and the equipment manufacturers, at their executive levels, have resolved to take an active role in the formulation of the farm bill which will control and guide the agricultural economy of the future. We want you to know that as an association and individually, we stand ready to provide whatever assistance you may seek from us in that endeavor.

Senator PRESSLER. Well, thank you very much. I'm glad to hear that you are getting involved in the farm bill and helping to write it for the first time. That's a very significant change, and it indicates the interest and concern that you have about the prices.

John, tell me a little bit about what you've said about the effect on machinery sales and credit and power equipment dealers. I know a lot of these companies, Allis-Chalmers and maybe John Deere, International, I don't know, have gone into a lot of industrial and road equipment, I've noted, where they used to be principally farm equipment. Is that true? Have they shifted out of the agricultural area? And why is that? What's happening in the industry?

Mr. MULLENHOLZ. Well, I think that there is some expansion into the industrial area, but there is also a great deal of compression within the farm equipment manufacturing industry itself. As you probably are aware—I'm sure you are aware—the International Harvester Equipment Division was sold to Tenneco, which owns Case. As a result of that we're going to lose, just as a result of that merger, somewhere between 800 and 400 dealers. It hasn't been clear; we've been given different figures. But that's a significant number, right there.

Now, there are rumors—I read about them; I don't want to talk about things I've heard—but what I've read in the newspapers is that there are discussions among some of the other manufacturers as far as combining, merging, that sort of thing. I have no personal knowledge of those, so I can't talk about it, but my own impression is that we're going to see more of that. There was overproduction leading up into the 1980's, a tremendous amount. Some of the things that you've heard today about dealers going out of business were the results of an enormous amount of inventory out there on their lots, and they just were unable to keep up with the interest payments to the point where they decided that it was easier to close their doors.

So that yes, you are going to see a great deal of compression. You're going to see, I think, leaner and larger—I say leaner, they're going to be cutting down on a lot of expenses—but they're going to be larger dealerships, and they're going to be serving many, many more farmers. Farmers are going to have to travel longer distances to get to the dealership. They're not going to have two and three in every town like they do now. You're not going to have, perhaps, as many competing brands in a particular town. By and large, the dealers are very loyal to their lines. They've been reluctant to take on other lines, but they're having to do it in recent times.

So that is, in general, what you're going to see, and the farmers, of course, are the ones that are going to suffer. However, when you look at the size of the farms, the size of the farm is increasing. They are better equipped, perhaps, to travel the longer distance and to deal with this shrinking dealer organization.

Senator PRESSLER. I think that both Senator Bumpers and Senator Dixon, here earlier today, pointed out the credit efforts that are occurring in Congress.

Now, in terms of extending credit to a farmer on the sale of a tractor, what policy do you recommend to your dealers?

Mr. MULLENHOLZ. By and large, Mr. Chairman, the credit that those farmers are going to get to buy that tractor is going to come from the manufacturer's lending arm. It's not going to come from FmHA, it's not going to come from any of the other Government programs. It may come from the bank, but I think you're going to see the farmers who get that credit use it for other things. They're going to use it to get their crop in the ground; they're going to use it for expendable, as opposed to durable, goods. Farmers can, if they can qualify, get the credit they need from John Deere, from IH—formerly IH, or from now Case-Tenneco—any one of those lending institutions. But it's important to note that the individuals who make the decisions as to whether to loan to those farmers use the same criteria as the local bank, as the PCA, or whatever you're going to use as your lending arm; those analysts are going to reach the same conclusion. And it's a question of whether the farmer himself is in a condition to do that.

There was an interesting statement by Senator Dixon about Moultrie County. I just happen to have——

Senator PRESSLER. Where is—how do you spell that? I've got to look that up. Moultrie County?

Mr. MULLENHOLZ. You're asking the wrong individual.

Ms. WOHLBRUCK. M-o-u-l-t-r-i-e.

Senator PRESSLER. M-o-u-l-t-r-i-e? Is that way down in the southern part of——

Mr. MULLENHOLZ. It's south-central, and it's a very, very good area.

Senator PRESSLER. Is that a southern expression, Moultrie, or is it just a name?

Mr. MULLENHOLZ. It's the name of a county.

Senator PRESSLER. I know, but where does the word come from?

Mr. MULLENHOLZ. I don't know. I can find that out for you.

Senator PRESSLER. OK.

Mr. MULLENHOLZ. This fellow is a manufacturer from around that area, and he gave a tremendous example of the problem that's happening. He said the prime land in that area in the early 1970's was going for $600 an acre; and as times got better and better, it went all the way up to somewhere around $4,000 an acre. And much of the credit in that county is dependent upon the land values and was reflecting $4,000 land values. It's now selling for $2,400 an acre. Now, that's an enormous reduction in the value of a farmer's assets when that happens. On the other hand, when you look at the increase from $600 to $2,400 an acre—I sat down and did the figures—that's 40 percent a year, and everyone would love to have their assets increase at 40 percent a year.

We have so many paradoxes out there in terms of the credit and the plight of the farmer that I don't know that the Congress can easily come up with a program that's going to resolve many of these problems. And of course, we're faced with that problem. We don't directly have the problem that the farmer does in the sense of the credit because we can get the credit for the farmer if he qualifies from these lending arms of the manufacturers. On the other hand, if he's overextended at the bank he's going to be overextended everywhere, and the decrease in land values is going to prevent him from borrowing to buy equipment.

Senator PRESSLER. Now, I cited some figures in regard to the number of dealers going out of business in South Dakota and Minnesota, and you've expanded on that a bit. I guess equipment dealers would be classified as small businessmen in the sense that they have a franchise, usually; is that right? Or how does it work?

Mr. MULLENHOLZ. It is like a franchise. It's a dealership, a distributorship—or not a distributorship, it is much like the automobile dealerships in terms of the relationship to the manufacturer. Clearly, under anybody's——

Senator PRESSLER. All right. Is the number declining?

Mr. MULLENHOLZ. Of dealers?

Senator PRESSLER. Yes.

Mr. MULLENHOLZ. Tremendously. Tremendously. And it's going to continue to decline. That figure I gave you of a reduction—of the need, anyway—of 43 percent, that doesn't include the ones that have already gone out of business. I mean, this survey started in July.

Senator PRESSLER. I was very intrigued with that survey. But what does that mean to the man on the street in a small town? It means less service available, less expertise in the community to repair equipment, a longer wait for repair parts? What does it mean as a practical thing to a consumer of these agricultural products from a small business?

Mr. MULLENHOLZ. Well, let's look at two consumers. You've got your typical consumer in a small town. Frequently the dealer is the largest employer in that town; that's not unusual. He's a leader of the community. He's on the bank board and frequently he'll be a political figure—a mayor or a city councilman. Once he goes out of business, that town has lost a major asset, not only in terms of jobs but in terms of a real, solid community figure. Looking at his customer, once that happens the customer has got to find another source. He's either going to go to the competitor in the town or, if this was the only dealer in town, he's going to have to go to another town. And what we have seen is a dramatic increase in the number of miles that a farmer has to travel to get to that dealer.

As to the waiting time and the availability of parts and so on, I think that the manufacturers and the dealers will continue to be able to serve the farmer in a fashion that the farmer is used to. I don't think you're going to see a lack of service. I don't think that you're going to see a length in waiting time. You are going to see an increase in cost to the farmer as he has to bring the equipment 10, 15, 20, 30 miles to that dealer. You're going to see larger dealerships; it's obviously necessary to have larger dealerships in order to make up for the numbers that are decreasing. And those dealers are going to be dealing in larger volumes.

Senator PRESSLER. I might ask a question of Ms. Wohlbruck on the viability of some of the local communities. Your opening statement was very good. As I understand it—what, exactly, do your association members do?

Ms. WOHLBRUCK. They're the planning and development districts in South Dakota. Bill Folkerts in Watertown is the executive director on our board. They are small town officials, county officials, and mayors. These institutions were organized about 20 years. They are local, multicounty planning, and development organiza-

tions whose primary focus is on job creation in small towns and rural areas. They are concerned with nonfarm issues but obviously these are closely related in rural areas.

Normally we don't get much attention because the farm crisis, farm problems and agriculture are such an overwhelming part of rural America. I know you understand Mr. Chairman, that nonfarm jobs have helped many, many people keep their farms.

So that's what our members are doing at the local level—trying to create jobs, running SBA programs in rural areas, and trying to help small business and local governments.

Senator PRESSLER. Your local members are probably the best informed as to what's going on in the local town and the local economy, and also just in terms of community structure. You have already testified to this, but to put it into sharper focus, is there a devastation of community life in some of these rural towns and counties because of the farm crisis?

Ms. WOHLBRUCK. Yes; we had about 30 of our board members here, and they're from places like Watertown, SD, and Ogallala, NE, and Waycross, GA—not big cities, but small cities that serve the surrounding counties. It's very hard for us to talk about nonfarm data from those towns or even to get unemployment data. We were pleased to find a new USDA study that confirms what people have been telling us from local communities, namely that unemployment is definitely higher in many rural areas. Even so, there's a big undercount, in rural areas. People tend not to go on unemployment and get counted in the big numbers. One of my members from Georgia recently told me that people think everything must be fine in the Sun Belt, but he said, "if you take Atlanta out of Georgia, you have Mississippi."

I think a lot of the big numbers on economic conditions and employment and the upturn in the economy really are masking serious problems in small towns and rural areas. I know this is the case in Minnesota but I don't know what the overall numbers are in South Dakota. That is our concern and what we're trying to do is raise this as an issue as part of the farm crisis. People must begin to understand what's happening to local communities.

Senator PRESSLER. What actions are the development organizations taking to reverse the decline in rural communities, because that's hard to do if the basic economy is not there?

Ms. WOHLBRUCK. Well, I think that the 503 Program is a great example of what local, rural people will do with a program. It really wasn't designed for rural areas; it was, I think, designed for big cities, but our folks out in South Dakota and other States saw what small business people needed was lower rates on loans, to help with their development. Over half of the certified development companies are run by these multicounty organizations like NADO members, and they have a terrific track record and very low default rates. I think overall the program has a 1- or 2-percent default rate. With rural banks loaned up on agricultural loans, there is no money for entrepreneurship out there in rural areas.

Another thing we're doing, and I think you may be aware of it, is a national demonstration project with the Small Business Administration to provide circuit-riding management assistance to small businesses in rural areas. We have one site in North Dakota, one

in South Dakota, and one in Colorado. People on-site in these areas with the skills to help the small business people, the main street people, do the basics that need to be done so they can survive, even in a declining economy. There is a lot of desire out there to get into the private enterprise system. It's just that the skills aren't there in the small towns to help them.

Senator PRESSLER. Now, I might address this to both of you. Will the depressed economy in small rural communities soon begin to affect larger communities and eventually the entire economy? Are there spillovers to the bigger cities that are apparent to you from your points of view?

Ms. WOHLBRUCK. Well, I think the rural minority is maybe the last minority, and it's probably getting smaller. We're losing population in more rural States, and I think the numbers that I've seen say that less than 3 percent are directly in farming but that 20 percent are in agricultural-related industries. You know, there are other kinds of industries in rural areas that are declining, like sewing industries that are going to Third World countries. It's interesting when you look at unemployment numbers that States that you wouldn't think of, perhaps, would be having increasing unemployment. North Carolina, which is perhaps a rural State, is getting an increase in unemployment because the small sewing plants that went down there for the low wages are now going to Third World countries.

So our members are concerned, and we hope that the farm problems will raise this issue up in people's consciousness.

Mr. MULLENHOLZ. Senator, I think that you're going to see a dramatic change in the demographics as the size of the farm changes. You're going to see larger farms and you're going to lose some small communities. I don't think it's going to have an impact, necessarily, on the larger communities; I think they're going to survive. The phenomenon that I've noticed with respect to our dealers is that those that are closer to the larger communities are doing pretty well. The reason is that the land values have not decreased. You get near a metropolitan area and the land values in that major city tend to have an impact far out in the countryside. There is some development as you get away from the city, and the potential of housing and so on keeps the land values of the farmers up and they're able to borrow, and they're able to do pretty well.

But you are, I think, going to see a loss of some of the smaller communities, or at least they're not going to be in the same condition they were 5 or 10 years ago. And that's going to be as a result of needing fewer people on the farm.

Senator PRESSLER. You just pointed out that the implement dealers have been a major source of financing for farmers to purchase farm equipment. Will there be an increase in the number of farmers who lease equipment rather than purchase it? And what advantage or disadvantage does leasing provide a farmer?

Mr. MULLENHOLZ. Well, leasing is a very small fraction, or percentage, I should say, of the financing used today. I think that the reason for that is that the farmer is not used to it. The farmer knows equity; he likes to know that he owns something; he likes to know that he's got title to it. And not only do I think that, I know that. I grew up on a farm; I know farmers, and leasing is a strange

beast to them. They don't understand it. They will pay forever on a piece of equipment and not own it.

It does have advantages in this day and age because they don't have to put any money down. Leasing is sort of a reverse type of financing; you pay at the end rather than at the beginning. And that has a great deal of advantage to any businessman who is short on funds. You don't put any money up; you simply go in—if your credit's decent and the dealer thinks you can make money, or enough to pay that lease over the period of time, you can get a new piece of equipment without trading an old piece of equipment in. So there are tremendous advantages.

The Congress has also made it more advantageous to lease farm equipment. There are provisions in the code which permit a farmer to lease up to $150,000 a year of farm equipment under more favorable terms—it's an offshoot of the old Safe Harbor Leasing, the battle that we went through in 1982. We were able to save a so-called finance lease arrangement where the ultimate payment at the end of the lease can be as low as 10 percent. It can be lower or higher, depending on the ability of the farmer to pay.

Senator PRESSLER. They wouldn't get the investment tax credit, would they, if they leased?

Mr. MULLENHOLZ. The lessor has the option of either keeping it or passing it along. It depends.

But this, again, depends on the liquidity of the farmer, his ability to pay. If he is a poor credit risk, then he's going to have to pay a higher lease payment, and the residual payment can be as low as 10 percent. If he's a good risk, conversely, they're willing to loan him—or lease him—that piece of equipment on a basis of 30 or 40 percent residual value. That means he's only financing 60 percent over whatever the term of the lease is, 4 or 5 years. So it's a great advantage, and the dealers and the manufacturers are willing to work with the farmer in that regard.

But it's a psychological problem more than anything else. Only your more sophisticated farmers are taking advantage of it.

Senator PRESSLER. Well, I thank you both very much for your testimony.

I want to call forward four farmers from South Dakota who are not testifying, James Kaufman of Delmont, Don Bowman of Fedora, Curtis Huther of Parkston, and Jim Sandness of Woonsocket, for any comments they might have. We will have to limit this to about 10 minutes under committee rules, and if one of you wishes to be a spokesman—but I thank you very much for being here. I'm proud that you're here. I know that we had several of our legislators here yesterday. I will call on anyone who has something to say. Since the purpose of this hearing is to look at the impact of the agricultural crisis on other areas, although we'll hear whatever you have to say, I know two of you, Don, I think you and Jim are school board members, from which positions you could certainly have relevant comments to make. Or if any of you have any reports on the main streets, how small business is being impacted in your towns.

Mr. BOWMAN. Well, I'm Don Bowman from Fedora. And first of all, it's a great honor to be here, Senator Pressler, and have you listen to a few words we have to say.

We were sent here, all expenses paid, by Dakota Cheese, Inc., in Mitchell, SD. I got the phone call Monday morning at 10 o'clock and they wanted to know if I could have my bags packed and on a plane at 12:30 out of Sioux Falls, Tuesday. So we did some quick work and got it done and got up here.

We do not have anything arranged, but we will share a few words with you, and maybe we can add on here.

I am also a board member on the Howard School Board, and I'm a board member on the Miner County Ambulance Board. I also have a degree from Dakota Wesleyan University.

As a starter, my wife works for a local co-op, 1½ miles from our place in Fedora. It shuts its doors the first of April. We had a meeting the other night and voted to shut it down. It has, I think, a backlog of $450,000 that they don't know if they're going to be able to pay.

As far as the schools are concerned, in Howard we have dropped from approximately 500 to 300 students. Not necessarily everything to do with agriculture, but that isn't near as bad as my neighboring school over there, Canova, which is about a 9-mile jog from Howard. Last year they were at 44 students; this year there are 28 students, and next year's projection, I believe, is around 21 students.

Now, in Howard we're making a 5-year projection right now, and we don't know where to go. If this thing does not change out there in rural America, I don't know how many young men we're going to have left out there. In our schools, of course, our families of people that are under 40 or 45 years old—and these are the young people that are out there trying to keep things going.

We are all dairymen, all four of us here, and we have quite a problem out there that people here do not realize. We sent our whole legislature out here and I think a majority of South Dakota was quite upset that President Reagan did not meet with them. We realize that he is a very busy man, but it would have been nice.

We feel that our country should come first. We have a great country and we want to keep it that way.

My neighbor, for instance, took a load of hogs to Sioux Falls Stockyards here this winter, and he waited approximately 2 hours to unload because there were semiloads of Canadian hogs being unloaded, which are subsidized by the Government. Now, that makes the guy pretty disgusted. We don't want—we aren't asking for a bailout. We would like to see some low interest and a slowdown on the imports, if not completely stopped. We feel that would help.

There are some poor managers out there; we realize that. They're in any business in any part of the world, in any part of the Nation, and that we can't do anything for. But we do feel that a lot of us are struggling out there. My newest tractor is 17 years old. My farmhand tractor is 30 years old, and we don't feel that some of us have blown money; we're just trying to hang in there.

I was locked in, in 1981, with a percentage interest of 20 percent. Now, I think everybody knows there's no 20 percent profit in farming. I've got to make a living and I've got to pay all my bills beside that, and it didn't even pay the interest. I started with nothing, bought my own farm from teaching; I taught school for 15 years, and I milked cows on the side and was burning two ends of a

candle and decided to go on my own on farming, and I was doing pretty good until this interest rate started climbing up there, which was very bad.

I do not have a degree in math, but I don't believe that anybody that does have a degree in math can shove a pencil for 3 hours and make 2 percent inflation and 20 percent interest work. It is very, very difficult.

The hospitals in South Dakota are all in trouble. Sioux Valley Hospital, which is a very big hospital in Sioux Falls, has presently dropped its practical nursing program. Now, that's sad. I milk cows in the morning and I hear all the local hospitals begging and advertising for business so that they can operate. This is something that we don't need. We have a neighbor there with four kids; the oldest one is a seventh grader, I believe, the youngest two are twins; they are in kindergarten. They have no drop of hospital insurance. None whatsoever, because they cannot pay the hospital insurance bill. And that's sad.

You talk about businesses like our machinery dealers and that. My combine is a 1963 No. 42 John Deere combine. You can't hardly buy parts for it, but I make it work. But what happens if I've got to order, with all these businesses shut out there? I've got 100 acres of grain laying down on the ground that's probably 60 or 70 bushels of grain. I break down at 10 o'clock in the morning; I run to town, get picked up for speeding, and they've got to order the part. It'll be there in 3 days. The next day a cloud comes and a hail storm wipes out my grain. What happens?

Then you go to the bank and they say, "Well, what happened? Your cash flow said you had so many bushels of grain here."

This is what we do not want. We're not asking for a bailout. We read an article in the Times last night which we did not like at all, and we realize not everybody understands exactly what's all going on, but we want you to know that we're trying out there, 100 percent, all the way.

This is the president of the school board in Woonsocket, which is about 30 miles from where I am.

Senator PRESSLER. Maybe you could make some comments as to your observation of the small businesses on the main street in your town.

Mr. SANDNESS. In Woonsocket, we hardly have any left. Our last implement dealer closed his doors this spring.

Senator PRESSLER. What kind of an implement dealer was that?

Mr. SANDNESS. He was John Deere, and then he eliminated the John Deere part and went Farmhand and used, and he said he lost $60,000 in the last 3 years, that he should have quit 3 years ago. That's kind of like farming. If everybody had quit 3 years ago, we'd be further ahead.

Senator PRESSLER. How about the school board situation? What's this done to revenues?

Mr. SANDNESS. Well, we're getting less kids and it's getting harder to—we've got to give our teachers raises every year, of course, to keep up with everything, but we're about at the limit on taxing our land. And with the land going down in value, I don't know where the money's going to come from.

There have been several farm people in our area that have—one case last winter—a family of five just packed their bags and left. And everybody thought he was doing a good job. He worked from 5 in the morning until, several times, 1 or 2 o'clock in the morning. And he quit, and he said he should have quit a long time ago.

The small towns, they're going to have it real hard. Our school is getting old; we're going to have to do some work on it. But I don't know. It's one year at a time.

Mr. BOWMAN. One of our county commissioners told some of the board members the other day that he feels that a lot of the tax money, your property tax money, has been borrowed with operating money. And the way things are right now, he fears what we're ahead of this fall because the guys are not getting operating money. And he said we could possibly be looking at a very bad situation on the tax scene. So we don't know, even in the school situation, what we're up against.

Senator PRESSLER. Well, I thank you, and if you have additional thoughts later today you may write them down and I will make them a part of the record. And later, when you get back to your local communities, if you would do an informal survey—I don't want any confidential information—of your small business people as to what is happening, how much their sales are down, I'd appreciate getting that.[1]

I think that we need to build a coalition of the National Federation of Independent Businessmen, of the independent bankers and the other banker groups, and the machinery people that we've heard this morning. For the first time in history the machinery dealers' association is participating in helping to write the farm bill. And I've got to be in a meeting in Senator Dole's office—10 minutes ago—so I'm going to have to go.

But I do appreciate your being here. You know, when citizens come to Washington, people say, "Well, what's the use in going to Washington?" But you do have an impact in our system of Government. Every little bit helps, and we thank you for being here.

I'm going to conclude this hearing. I want to thank you for being here.

I call this hearing to an end.

[Whereupon, at 11:45 a.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[Additional material follows:]

[1] Information not available at time of going to press.

STATEMENT OF NATIONAL COUNCIL OF FARMER COOPERATIVES

BEFORE

SENATE SMALL BUSINESS SUBCOMMITTEE ON FAMILY FARM

WASHINGTON, D.C.

The National Council of Farmer Cooperatives appreciates very much the opportunity to submit its views regarding the effects of the farm credit situation on farm suppliers and cooperatives.

The Council is the central organization of the nation's farmer owned cooperatives, representing 109 marketing and supply cooperatives, 32 State Councils, and the 37 banks of the cooperative farm credit system. Our members in turn represent over 5,000 local cooperatives with a combined membership of nearly 2 million farmers.

Low commodity prices, continued high interest rates, the over-valued dollar, declining export demand and a combination of other factors have all resulted in a deteriorating farm economy. The effects have been felt not only by farmers, but also by farmer cooperatives, particularly supply cooperatives.

Within this segment of the industry are more than 30 regional and interregional cooperatives which generally provide manufacturing and wholesaling functions for a network of several thousand local cooperatives throughout the U.S.

These local cooperatives in turn serve as the principle direct link with the farmer and engage in the distribution of needed farm inputs, including seed, fertilizer, chemicals, fuel, feed and equipment.

Any savings incurred through these operations are distributed to the farmer members of the cooperative(s) as a function of their patronage. As a result, there is a unique accountability in terms of service and the availability of needed supplies at reasonable prices.

This underscores why such cooperatives have and continue to attempt to be responsive to their farmer members, particularly those who are experiencing credit difficulties. In many cases, these cooperatives provide their farmer members with needed inputs on a credit basis. But with continued low commodity prices, high interest rates, declining land values, and weak export demand, such unsecured "loans" carry a high risk. To the extent that losses do occur, then the impact is felt not only by the cooperative, but all other farmer members.

Looking at the current situation, we believe there are three main areas of concern which need to be addressed. First, of course, is the short term. For a growing number of producers the question is whether they are going to be able to obtain financing for this year's crops.

In this regard, the National Council's delegate body at our recent annual meeting in San Antonio, Texas unanimously endorsed administrative as well as legislative action to further respond to the short term credit needs of agriculture.

For this reason, we were very much encouraged by the Administration's announcement of additional initiatives aimed at making its Debt Adjustment Program (DAP) more flexible in an effort to help meet the credit needs of producers. At the same time, however, we continue to believe that additional measures may be needed such as those contained in legislation which has already passed both the House and Senate.

Secondly, we believe it may also be necessary to determine what measures may be needed to provide for a sound restructuring of existing farm debt in order to meet the needs of borrowers and lenders alike. In this regard, a number of specific recommendations were outlined in earlier testimony before this Subcommittee and the House Agriculture Subcommittee on Conservation and Credit by representatives of the Farm Credit Council, which is affiliated with the National Council.

Finally, we believe it essential to look not only at what programs and policies may be needed to provide short term relief, but which will help restore profitability to agriculture in the long term. For no solution in the short term will be satisfactory if it does not help achieve that goal.

As indicated earlier, the current financial crisis facing agriculture is due to a combination of factors. And, nowhere has this combination of factors had a greater impact than on our ability to compete in the international marketplace. Overall, during the past 4 years, the volume of U.S. agricultural exports has dropped by more than 22 million metric tons, or approximately 15 percent. Not only are we faced with declining exports, but we are losing market share. Unless this issue is addressed soon, it is difficult to see how we can achieve the goal of long term stability and profitability in agriculture.

It is within this general framework that the National Council believes a number of actions are essential, including:

(1) Development of sound fiscal and monetary policies to reduce the deficit, lower interest rates, and address the problem of the over-valued dollar;

(2) Passage of legislation in conjunction with the 1985 Farm Bill aimed at maintaining farm income, while enhancing agriculture's ability to compete in the international marketplace; and

(3) Establishment of an aggressive trade title in the 1985 Farm Bill to counter unfair trade practices, enhance world demand, and compensate for the effects of the over-valued dollar.

Again, it is within this framework that we believe action is necessary if we are to achieve the goal of long term stability and profitability in agriculture.

Jim Nelson
Box 10
Timber Lake, SD 57656

Senator Larry Pressler
411 Russell Senate Office Building
Washington, DC 20510

Dear Sen. Larry Pressler:

I live in Timber Lake, South Dakota, population 660. Timber Lake is located in Dewey County on the Cheyenne River Indian Reservation. It is the county seat and second largest town in the county. The town of Timber Lake is surrounded by about 172 farms and ranches in both Dewey and Corson counties. It is upon these farms and ranches that the town depends. Without them there is no reason for the town to exist. There is no industrial employment within 100 miles. So, directly or indirectly, we all depend on agriculture.

My wife and I moved here in 1980 and bought the local newspaper from a family which had it for 35 years. At that time we were very impressed with this community. There were about 50 businesses of varring size. Many of these were owned or operated by younger people. There was obviously a progressive business community and the town seemed to be on the move. The school was good and people had pride in their community. When the 1980 census came out, it was discovered that Timber Lake was one of only two towns in this section of the state which has experienced steady growth since 1950. In fact, the population was at an all-time high; something that is not true for very many towns or cities in South Dakota.

Due to the failing situation in the agricultural sector, Timber Lake has experienced a steady decline in business activity. The total gross sales in Timber Lake for the past 6 years are as follows:

1979	$7,161,000
1980	6,362,000
1981	6,273,000
1982	6,154,000
1983	5,710,000
1984	5,265,000 (estimate)

This represents a 26% drop since 1979 with no consideration for inflation.

Since 1980, seven businesses in Timber Lake have gone out of existence -- two through bankruptcies, four have just closed the door or liquidated, and one sold out to a competitor. Only one of the owners was anywhere near retirement age and he was the only one able to sell.

Presently, I would estimate, that there are 9 businesses just barely hanging on. Several of these are larger and therefore more important to the town's future.

No one here has seen much of the economic recovery which we hear is sweeping the land.

The farms which surround Timber Lake vary a great deal. There are small dairy operations, most of which are diversified to some degree and grow much of their own feed. There are a number of cow-calf operations, some of which are quite large. There are also grain farmers of various sizes. Spring wheat, corn, barley, oats, and alfalfa seed are all raised, often as part of a diversified operation. There are also sheep, hogs, and horses raised commercially in the area and there are a number of purebred cattle breeders and a few smaller feed lots within a short distance of Timber Lake.

Although there are a number of Indian or "breed" operators within the Timber Lake area, most of the families who farm or ranch in the immediate area are not Indian. Many of the families who are on the land today are the descendants of immigrants who homesteaded here 75 years ago.

Not since the 1930's have so many families been in such dire straits economically. A number of young families who have invested a dozen or so years of their life on the farm have left with just the shirt on their back.

Recently a small group of business people and farmers met to discuss the problems facing the whole community. One of the things they did was analyze the relative financial condition of the area's 172 farmers and ranchers. The results were startling even to us:

Present Status	Operators	
No Debt	25	45% —
2:1 Debt ratio	48	
1:1 Debt ratio	35	55% +
less than 1:1 Debt ratio	63	

Anyone with a debt ratio of 1:1 or less is in very serious financial trouble. Even with immediate credit relief, some of the lowest 63 will probably not be farming in 1985. As they leave and land values drop further, others will slide toward them. Unless a comprehensive, long range farm program which assures a decent price for agricultural commodities is passed the community will lose another 50 producers by 1987.

In our analysis we found that all four of the debt groups had ranchers and farmers, old and young, big and small, diversified and single cash crop, Indian and non-Indian operators, and were commercial bank, PCA, and FmHA borrowers.

For credit we have a small family owned bank, a PCA, the FmHA office, and various larger out-of-town lending institutions. It is uncertain how much longer the PCA will be here. They had three million dollars in losses last year in Northwestern South Dakota and have recently had a very serious run on their only good borrowers here in Timber Lake. The local FmHA office had a fairly liberal lending policy during the 1970's. Then in

the early 80's they began to tighten up on credit.

In 1983 a sample audit of 12 local FmHA borrowers disclosed that 7 of 12 were delinquent at the time they received their 1982 loans. With the loans to four of these borrowers appearing to be questionable, as security for the loans did not adequately assure loan repayment. Outstanding loans to these producers totaled $1,936,860 and security for the loans was appraised at $858,980. Therefore, the loans are undersecured $1,077,880. The audit also showed that management assistance tools such as: 1) long time farm and home plan, 2) yearend analysis of actual income and expenses, 3) a record keeping system and cash flow statement, and 4) financial analysis, were not required or prepared by the county FmHA office.

Although the audit did not disclose any indication of possible illegal activities on the part of the county supervisor, he nonetheless was transferred and is no longer with FmHA.

Since 1981 there has been a very dramatic increase in delinquent real estate taxes. There are presently about $200,000 in taxes owed to the counties, some having been delinquent since 1978. This represents about 12% of the taxpayers and about 60,000 acres of agricultural land that technically the county owns, even though the people are still on the land.

We need immediate credit relief for all our farmers and ranchers. And, in the long term America needs a system of agriculture where a profit can be made by the small and medium-sized family farm. This program would not have to cost the taxpayer a great deal. If the benefits are geared to the small and medium sized farm and no big operators or outside corporation could receive these benefits, then maybe the family farm can be saved.

Timber Lake and the community around it still have some chance. They have a good K-12 school, they have a cheese factory, they have many government

offices, and it is the county seat. But, if help doesn't come soon, all may be lost in a centrifuge of debt, liquidation, foreclosures, bankuptcies, and abandoments.

There are many Timber Lakes out here. They are filled with and surrounded by hard working people who will succeed if just given a chance.

Sincerely,

Jim Nelson